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(ROYAL COMMISSION  
ON  
(CO-OPERATIVES)

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1945

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PROCEEDINGS  
(OFFICIAL REPORT)

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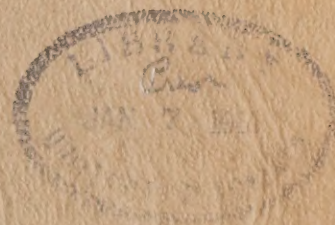
VOLUME No. XVII

PLACE Ottawa

DATE April 13, 1945

PAGES 5502 - 5599

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ROYAL COMMISSION ON COOPERATIVES

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Ottawa, Friday, April 13, 1945

VOLUME XVII

(Pages 5502-5599)

C o n t e n t s

Page

Chambers of Commerce  
of the Province of Quebec

Gilbert Latour, examined (brief, 5506)

By Mr. Brossard 5504

By Mr. Fillmore 5585

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ROYAL COMMISSION ON COOPERATIVES

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The Commission appointed to inquire into the present position of cooperatives in the matter of income and excess profits tax, organization and business methods and operations, and the comparative position of persons engaged in business directly competitive therewith, met in Ottawa, on Friday, April 13, 1945.

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P R E S E N T:

The Hon. Mr. Justice ERROL M. McDOUGALL, Chairman

B. N. ARNASON	)	
	)	
G. A. ELLIOTT	)	
	)	
J. M. NADEAU	)	Commissioners
	)	
J. J. VAUGHAN	)	

Eugene T. Parker, K.C.)	Counsel
Roger Brossard, K.C. )	Associate Counsel

Major H.D. Woods)	Associate
J.A. Chapdelaine)	Registrars

Colonel G.W. Ross	Executive Secretary
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A P P E A R A N C E S:

W. B. Francis	Group of Cooperative Associations
W. P. Fillmore, K.C.	Private Grain Interests
R. H. Milliken, K.C.	Saskatchewan Cooperatives; Associated Growers of British Columbia, Limited, and Affiliated Locals

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THE CHAIRMAN: Gentlemen, before we take up the day's work I think I should make some reference to the great and tragic loss which has been suffered by the republic to the south, in which we in Canada also feel that we have lost a great and constant friend in the person of President Roosevelt. I believe he will go down in history as one of the greatest presidents of the United States and I want to pay this tribute to him; and to say only that as truly as any soldier who has been killed at the front, President Roosevelt has laid down his life for his country. No man can do more.

I would ask that we all stand for a moment in honour of the memory of this great president of the United States.

THE CHAIRMAN: Well, sir, what is the programme this morning?

MR. BROSSARD: We have this morning a brief from the Federation of the Chambers of Commerce of the province of Quebec, I believe, and Mr. Latour is here to represent the Federation of the Chambers of Commerce of the Province of Quebec.

GILBERT LATOUR

residing in Montreal, who, having been  
duly sworn on the Holy Evangils, deposed  
as follows:

BY MR. BROSSARD:

Mr. Chairman, the brief prepared by Mr. Latour contains information on the procedure followed by the Federation of the Chambers of Commerce of the province of Quebec, and on the way the brief itself was prepared and submitted to the various chambers constituting the federated group. I have only two or three preliminary questions to ask Mr. Latour, and I would like to ask them after he has read his brief, which he will kindly do first.

In fact, I believe it would be better to have Mr. Latour



read us his brief first; because all the facts we are interested in are mentioned in the brief, partly at least.

THE CHAIRMAN: Very well.

MR. BROSSARD: But I would like to have Mr. Latour identify himself and tell us in what capacity he represents the Federation of Chambers of Commerce of the province of Quebec.

THE CHAIRMAN: Yes, it might be perhaps advisable for you to ask him in what capacity he represents it.

MR. BROASSARD: Yes.

Q. In what capacity do you appear before the Royal Commission of Inquiry on the Cooperatives this morning?

A. As General Secretary of the Federation of Chambers of Commerce of the province of Quebec.

Q. I understand that you are secretary of the Chamber of Commerce of Montreal as well? A. Yes.

Q. You hold the dual position of Secretary of the Chamber of Commerce of Montreal, and of Secretary of the Federation of Chambers of Commerce of the province of Quebec?

A. Yes.

Q. You are secretary of the Chambers of Commerce of the Province of Quebec, and of the Federation? A. Yes.

Q. Which was incorporated in what year?

A. In 1909; it was incorporated under a special federal statute, known as 9-10 Edward VII, Chapter 99.

Q. Now I would ask you to read us your brief.

A. Would it not be better for me to mention a few changes to be made in the procedure with respect to this brief?

Q. Yes, and I would also like you to number the pages of your brief as you are reading, because the copies are not numbered.

Q. Then, it would be preferable that I point out the





changes to be made as I proceed with the reading of my brief? A. Yes.

THE CHAIRMAN: Yes.

THE WITNESS:

Chamber of Commerce of the Province of Quebec

I start at page 1, which reads as follows:

"The Chamber of Commerce of the Province of Quebec comprises eighty-two chambers of commerce and boards of trade. It was founded in 1909.

"It derives its legal existence from a special federal act 9-10 Edward VII, Chapter 99.

"Its object is to coordinate the work of its chamber members on the provincial plan.

"It is administered by a general meeting that assembles each year and delegates its powers to eighty-four administrators representing twenty-three administrative regions which in turn elect their officers. The officers and regional administrators form the executive which looks after the management and the orientation of the Chamber between two general meetings.

Authority for the Brief:

"1. In December, 1943, the general meeting which sat for two days at Quebec, formed a committee which deliberated for eight hours with the mission of formulating the official opinion of the chamber with reference to cooperation. The committee which consisted of about fifty delegates representing in the majority the cooperative movement reported to the general meeting. The latter recommends to all Chamber-members to study the business methods of cooperatives.

"2. In 1944, through the medium of its secretariat, the provincial chamber repeatedly asked the chambers to





study the cooperative movement.

"3. In September, 1944, at La Malbaie, the general meeting accepted a report of one of its committees to the effect that a request be made that cooperatives be placed on the same footing as ordinary enterprises in respect of the income tax.

"4. Since the Canada Gazette published the order in council authorizing a royal commission to conduct an inquiry on cooperatives, a certain number of chamber-members asked the provincial chamber to make known its opinion.

"5. As its regularly called meeting of February 13, the executive council of the provincial chamber assembled at Quebec instructed its secretary to prepare a brief asking that cooperatives and ordinary enterprise be placed on an equal footing in regard to income tax, without asking, however, the taxation of the patronage dividend.

"6. The text of this brief the tenor of which represents the official thought of the chamber of commerce of the province, was forwarded to all members of the executive council and to all chamber-members for approval. Here are the results of that course of action:

I continue at page 4:

And here, figures must be changed, the figure 18 at page 4 must be changed, this is at the very top of the page. The text reads "18 chambers", one must point out....

THE CHAIRMAN: Where is that?

A. At the very top of the page.

Q. How many are there? A. Twenty chambers.

Q. Twenty? A. Yes. And under number 4 which reads:

Drummondville, one must add Farnham, Quebec.





Q. Farnham? A. Farnham, Quebec. And under number 15 which reads: Sherbrooke, one must add Trois-Pistoles, and opposite Trois-Pistoles, one must place an "x" in the column: council meeting; as for Farnham, I cannot state definitely, I have no definite data.

BY THE CHAIRMAN:

Q. That would be an "x" in the serond column?

A. Yes, place an "x" in the second column, and then the total of that column must now read: 5 instead of 4, and one must enter the two additional ones which make the total of twenty chambers instead of eighteen.

Twenty chambers approved the brief without any qualifications whatever,

"Meeting of the Executive of the Board General			
1.	Beauceville	x	
2.	Charny	x	
3.	Chicoutimi		x
4.	Drummondville	x	
	Farnham		x
5.	Grand'Mere		x
6.	La Sarre	x	
7.	La Tuque		x
8.	Montreal (district of)	x	
9.	Quebec		x
10.	Richmond & Melbourne		x
11.	Roberval		x
12.	St. Jean	x	
13.	St. Jerome		x
14.	Ste. Therese de Blainville	x	
15.	Sherbrooke	x	
	Trois Pistoles		x
16.	Trois Rivieres		x



	<u>"Meetings</u>		
	<u>of the Executive</u>	<u>of the Board</u>	<u>General</u>
"17. Val d'Or			x
18. Valleyfield	<u>          </u>	<u>      x      </u>	<u>          </u>
Total	6	5	8 1"

Now, on the next page, page 5, figure 8 at the top of the page -- 8 chambers -- should read 10 chambers.

BY THE CHAIRMAN:

Q. This is 5, is it not? A. It reads: "have disapproved the brief".

BY MR. BROSSARD:

Q. No, "have approved the brief"?

A. Oh, then, excuse me, there is an inversion, and so, it becomes page 6 of my own brief.

BY THE CHAIRMAN:

Q. All right, the 10--? A. No, the 5 is not changed, then let us proceed with the next page at once.

BY MR. BROSSARD:

Q. The next page would be page 6? A. Yes.

Q. "8 chambers have disapproved--"

A. Yes, the 8 should be changed into 10, and then, at the top, you have 10 chambers have disapproved the brief, and after number 1 which reads Amqui, "Cabano" should be added below, and an "x" inserted in the second column.

THE CHAIRMAN: Yes.

THE WITNESS: After number 8 which reads, Sayabec, Shawinigan Falls should be added, and an "x" inserted in the second column, then, in that same column, the second one, raise the total to 4 instead of 2.

On the same page, the figure "4 chambers have decided not to express an opinion" should be changed into 5, and the word "Levis" should be added before number 1 which reads "Nicolet".





A. No, the 5 is not changed, then let us proceed with the next page at once.

BY MR. PROSSARD:

Q. The next page would be page 6? A. Yes.

Q. "8 Chambers have disapproved--" A. Yes, the 8 should be changed into 10, and then, at the top, you have 10 chambers have disapproved the brief, and after number 1 which reads Amqui, "Cabano" should be added below, and an "x" inserted in the second column.

THE CHAIRMAN: Yes.

THE WITNESS: After number 8 which reads, Sayabec, Shawinigan Falls should be added, and an "x" inserted in the second column, then, in that same column, the second one, raise the total to 4 instead of 2.

On the same page, the figure "4 chambers have decided not to express an opinion" should be changed into 5, and the word "Levis" should be added before number 1 which reads "Nicolet".

BY THE CHAIRMAN:

Q. Levis? A. Levis; and insert an "x" in the third column, and now, the total of that column becomes 3 instead of 2. Do you wish me to read those figures?

THE CHAIRMAN: No, it is not necessary.

WITNESS: Nor the distinctions?

THE CHAIRMAN: No.

THE WITNESS: Five chambers have approved the brief, but with the following qualifications:

"(a) Mont-Joli - at a general meeting 'Reserves set up for social purposes should not be taxed.'

(b) Gaspe-Nord - at a meeting of the Board;

Jonquiere - at a general meeting;

Marieville - at a general meeting;





"Only profits made out of sales to non-members should be taxed."

"(o) St. Joseph de Beauce - at a general meeting

"That the tax be imposed on reserves and on profits made by the cooperatives on sales to non-members only."

## II

"10 Chambers have disapproved the brief.

	<u>Meetings</u>		
	<u>of the Executive</u>	<u>of the Board</u>	<u>General</u>
1. Amqui		x	
Cabano			
2. Contrecoeur			x
3. Saguenay county	x		
4. L'Annonciation		x	
5. Matane	x		
6. Quebec-Montmorency			x
7. St. Pascal			x
8. Sayabec			x
Shawinigan Falls		x	
	<u>2</u>	<u>4</u>	<u>4</u>

## III

"5 chambers have decided not to express their opinions:

Levis			x
1. Nicolet			x
2. Mont Laurier		x	
3. Ste. Agathe des Monts	x		
4. Ste Marie de Beauce			x
	<u>1</u>	<u>1</u>	<u>3</u>

At page 7, beginning with "47 chambers did not make known their opinion", the figure "47" must be changed to "42" and we must delete number 5, "Cabano", number 11, "Farnham", number 19, "Levis", number 42, "Shawinigan Falls," and number "44,"



"Trois Pistoles". Therefore, I repeat, in order to check corrections: figure "47" is changed to figure "42", the word "Cabano", which bears number 5, is deleted; the word "Farnham" which bears number 11, is deleted; the word "Levis" which bears number 19, is deleted; the word "Shawinigan Falls" which bears number 42, is deleted and the word "Trois Pistoles", which bears number 44, is deleted.

42 chambers did not make known their opinion:

- |                             |                                      |
|-----------------------------|--------------------------------------|
| 1. Amos                     | 24. Plessisville                     |
| 2. Baie des Ha! Ha!         | 25. Richelieu - St. Mathias          |
| 3. Bedford                  | 26. Rigaud                           |
| 4. Beloeil                  | 27. Rimouski                         |
| 5.                          | 28. Riviere du Loup                  |
| 6. Cap de la Madeleine      | 29. Rouyn-Noranda                    |
| 7. Chandler                 | 30. Ste-Adele                        |
| 8. Charlevoix-Est           | 31. St. Damase                       |
| 9. Charlevoix-Ouest         | 32. Saint Eustache                   |
| 10. Soulanges (comte)       | 33. Saint Hilaire                    |
| 11.                         | 34. Saint Hyacinthe                  |
| 12. Fort Coulonge           | 35. St. Jean Baptiste de<br>Rouville |
| 13. Gaspé                   | 36. St. Joseph de Drummond           |
| 14. Gracefield              | 37. St. Jovite                       |
| 15. Granby                  | 38. Saint Pie de Bagot               |
| 16.                         | 39. Saint Romuald                    |
| 17. Iberville               | 40. Saint Sauveur des Monts          |
| 18. Kenogami                | 41. Saint Tite                       |
| 19.                         | 42.                                  |
| 20. Longueuil               | 43. Thetford Mines                   |
| 21. Maniwaki                | 44.                                  |
| 22. Montmagny               | 45. Victoriaville                    |
| 23. Montreal Board of Trade | 46. Ville-Marie                      |
| 47. Warwick."               |                                      |





Now, let us take page 8. I apologize for making such changes but they are last-minute changes and there shall be no others.

THE CHAIRMAN: Have you checked these two pages?

THE WITNESS: Yes, therefore, at page 8, I read as follows:

"As the by-laws of the chamber of the province stipulate that the opposition of one third is sufficient to prevent a declaration and that only eight chambers representing less than one third objected, this brief represents officially and regularly the opinion of the chamber of the province of Quebec."

The procedure followed in order to obtain this result is outlined as follows: in the first place, we sent questionnaires to all chambers in the province of Quebec, containing three questions: "Do you approve the present brief?"; second question: "Do you disapprove of said brief?"; third question: "Have you any observations to make in the statement with regard to taxation?"

Then, we have asked the President and the Secretary of each chamber of commerce interested to sign the statement and to advise us whether this statement had been obtained following a meeting of the council or a general meeting. Such, therefore, is the analysis of the work done.

Now, there is page 9 entitled "Breakdown of the Brief".

If it may please you, we shall start at page 10 which begins by the word "Introduction". I read:

"Prior to the war, when the taxes levied were relatively moderate, the privileges granted to cooperatives were less apparent and their consequences could pass unnoticed. At the present time, the mode of distribution of state imposts between taxpayers capable of bearing them is closely scrutinized. The reaction is natural: the burden



is heavy and an attempt is made to lighten it on the one hand and on the other hand to distribute it equitably.

"It is certain that if the tax did not bear on joint stock companies, nobody would think of asking that co-operatives be taxed. Cooperatives and ordinary enterprises would be on the same footing in the matter of taxation. Only the individual would be taxed. It is the system that would involve the removal of the double taxation of the enterprise and its owner.

"The Chamber of Commerce of the province has no quarrel with the cooperative movement. The chamber reproaches it with nothing; it asks it to assume its share of state imposts to pay its share of the services of which it benefits.

"At the present time, exemption of cooperatives from taxation appears to many as a kind of injustice. For the ordinary business man (entrepreneur) the situation is painful. The business man must submit to economic laws. He must satisfy a need at a price such that the consumer finds it advantageous to avail himself of his services. Should he not obey this inexorable law, should he commit an error of judgment, he will disappear. His efforts will have been purposeless. His capital: this setting aside at the price of sacrifices, will be lost. If he succeeds, he will have the profit as remuneration. It will be the reward of a service rendered. Acceptance of his services at a price that satisfies him and the consumer is the outcome of his work. This price is made up of the cost of the service, the profit and the tax. Should one of these elements weigh too heavily, the business man will have to step aside. The action of the business man on the cost of the service is fairly limited.





"On the profit his action is limited by the extent of his risk and the competition with which he has to contend. As for the tax, he is powerless. In these times, the business man is convinced he works for the state ..... if even he could believe the situation is only temporary .... if he could constitute for himself reserves of adequate security? At least forty per cent of his profits, sometimes eighty per cent, are taken by taxation. However, a form of enterprise has taken shape alongside. Outwardly, it has all the characteristics of an ordinary enterprise. It obeys the same economic laws. It competes with it .... and the state exempts it from taxation.

"Your competitor benefits by a reduction of his operating costs because of a legal formula. Your competitor ensures his security by setting up for himself reserves which are, up to a certain proportion, denied to you, and by this fact improves his return.

"Because your competitor is exempted from his share of state imposts, your burden is increased proportionately. On the one hand, by reason of privileges, the cooperative sees its field broadening more and more. On the other hand, by reason of these same privileges, ordinary enterprise sees its imposts increasing constantly while its field of activity is narrowing continually. Let us carry the argument to the extreme point and one finds that ordinary enterprise has disappeared and the state must turn in other directions to secure the funds required for its services ....(this is at page 13) unless the citizens see their community needs satisfied by the social advantages of the cooperative?

"Admitting the cooperative thesis to the effect that there will always be people who will not be cooperators



and for the purpose of restoring the balance between ordinary enterprise and the cooperative, we submit in the pages that follow the reasons motivating our opinion to the effect that any enterprise engaged in the conduct of parallel operations in Canada should be treated in the same manner by the state in respect of the income tax."

I continue now with page 14:

"Cooperative Principles

"While the ordinary business man offers his goods and services with the hope of earning a return, the cooperative offers goods and services with the hope of passing on this return to its patrons or users who are its members. Cooperatives are associations of persons which aim at securing goods or services for themselves without the help of middlemen. These associations comply with certain rules, the principal ones of which are the following:

"Distribution of profits in the ratio of the volume of business of the members;

"Freedom for everybody to join a cooperative or to withdraw therefrom; the number of shareholders not being limited;

"One man, one vote;

"Cooperative education of members.

"Organization and Business Methods

"In the province of Quebec, cooperatives are incorporated generally under the Agricultural Cooperatives Act or the Cooperative Syndicates Act. They can also (and turn to page 15) be incorporated under a special act or the Companies Act.

"In one case as in the other, the members of a cooperative, like the members of a capitalized company, are responsible only to the extent of the capital they have subscribed.





"The cooperative constitutes by this fact a moral person distinct from its members. It is admitted that it can incur losses, certain cooperatives have, as a matter of fact, failed. It follows therefore that it can also make profits.

"The commercial operations of the cooperative are conducted in exactly the same manner as those of an ordinary enterprise carrying on the same business. It is particularly the manner in which profits are distributed that distinguishes the cooperative from the capitalist enterprise. The joint stock company, after creating necessary reserves, distributes its profits to stockholders proportionately to the amount of capital stock held by each of them. The cooperative too creates out of the profits it makes the reserves it deems useful. It remunerates the capital invested at a nominal rate and distributes the balance to its members in the ratio of their transactions. It is proper to examine very attentively this disposal of profits in the form of patronage dividends, reserves and of remuneration of capital in order to determine if a distribution of profits is involved.

"The joint stock company after creating necessary reserves distributes its profits to stockholders proportionately with the amount of capital stock held by each of them. The cooperative too creates out of the profits it makes the reserves it deems useful."

And now, on page 16:

"It remunerates the capital invested at a nominal rate and distributes the balance to its members in the ratio of their transactions. It is proper to examine very attentively this disposal of profits in the form of patronage dividends, reserves and of remuneration of capital



in order to determine if a distribution of profits is involved.

#### Patronage Dividends

"The cooperative aims at enabling its members to dispose of their goods or securing for them services or goods without resorting to a middleman. It claims it distributes the middleman's profit between the cooperators proportionately to their volume of business.

"To do so, the cooperative proceeds in two ways:

1. Sells to its members and/or purchases their products at the current price and makes a price adjustment at the close of the year in the form of a patronage dividend, or else
2. Sells at a lesser price to its members and pays them a price in excess of current prices"

Page 17:

"This latter method is not very popular with cooperatives. Yet it would enable the public to realize immediately the advantages of the cooperative, if there is an advantage, and would cause competitors to readjust their prices, if needs be, something that would be profitable to everybody. It would be unquestionably a social advantage that would not be limited to cooperators only.

"The cooperative prefers doing business at the current price and granting a patronage dividend to its members.

"The inconveniences involved in not following the current price in sales, one can read in a propaganda pamphlet on the cooperative (1) are numerous. The most grave inconveniences lie perhaps in exasperating trade and practically depriving the cooperative of the faculty of selling to the non-cooperator public. Unless there





were two prices, which should not be, the same advantage would be given to non-members as to members . . . .

The sale at cost price deprives the cooperative of the financial means of achieving one or the other of the objectives assigned to it: individual or collective saving, works of solidarity or propaganda. On the other hand, the sale at the current price makes provision for the selling costs and the other charges of the organization. It makes possible the payment of larger patronage dividends and constitutes by the very fact an excellent means of propaganda. It permits the increase of reserves and surplus earnings and helps the undertaking to free itself financially.

"(1) Agricultural cooperative (organization of improvement) by J. L. Descoteaux, Romeo Martin, Raynald Ferron, Department of Agriculture of the province of Quebec, 1943, page 98."

Now on page 18: "The worst drawbacks of selling at cost price according to the cooperators, would be:

- "1. To exasperate trade
2. To deprive practically the cooperative of the faculty of selling to the non-cooperator public.

"Supposing that the cooperative could exasperate trade by selling at cost price, that could only compel the latter to readjust its prices which would profit everybody, save perhaps the cooperative which would lose an excellent propaganda argument.

"If the cooperative could, without being exempted from taxation, sell more cheaply than its competitors, that would not be exasperating in any way; what is exasperating is that it can do so because it benefits by preferred treatment in the form of tax exemption.



"As for the second drawback mentioned by the co-operative's propagandist, that of being unable to sell to the non-cooperator public, it is more than the first a purely commercial argument which proves that the co-operative does not wish to restrict its operations to its members only.

Page 19:

"The cooperative derives from transactions with non-members profits which undoubtedly are like those of ordinary capitalist enterprise. The leaders of the cooperative suggest that the profits made on transactions with non-members be utilized for the creation of reserves. Whether profits thus earned are applied entirely to the reserve or not, they reduce the portion that should have been levied on patronage dividends resulting from operations with members and permit of the increase of the patronage dividend in the same proportion."

Page 20:

"Therefore, the patronage dividend includes indirectly a portion of the profits made with non-members. For it to be otherwise, it would be necessary either that the cooperative should do business with its members only, or that it grant the same patronage dividend to all its patrons, shareholders or not. Here is the principal question with reference to the patronage dividend: is the patronage dividend a distribution of profits? In our opinion, the patronage dividend paid in money within a relatively short time after the close of the financial year can be considered as an expenditure on the same grounds as the discount granted on the volume of business.

"We believe the cooperative tacitly pledged itself with its cooperator clients to grant them a price





reduction in the form of a patronage dividend. Thus, the patronage dividend is in a manner a clause of a contract and must by reason of this fact be considered by the cooperative as an expenditure. By virtue of this tacit understanding, the cooperator expects that the cooperative after making provision for its own needs (reimbursement of expenditures incurred, setting up of necessary reserves, return on capital) will return to him in proportion to his volume of business the profits secured on his transactions."

And now page 21:

"He looks upon this patronage dividend as a price adjustment and it is probable that without this hoped for patronage dividend, he, the cooperator would not have become one.

"Certain cooperatives have made a habit of declaring a patronage dividend part of which is paid immediately while the other part will be paid at a later date and represents because of that a loan by the cooperators to the cooperative.

"We believe that that would be, if the cooperative were exempted from the income tax solely on the patronage dividends paid to its members, a way of evading the act. This part of the patronage dividend that is not paid in ready money, may be likened to a distribution of profits rather than to a discount on the transactions. As a matter of fact, the cooperative undertakes to remit to its members the surplus on the year's operations it still has in hand after having provided for its own needs. One must therefore believe that the cooperative which borrows to pay its patronage dividend has not made provision, out of the profits made, for all its needs, and that it distributes part of its assets. With this



method, the cooperatives could forego setting up the reserves they need and which in certain cases constitute (and I continue on page 22) accumulations of profits. The same argument can hold for the payment of the patronage dividend in the form of a share of the cooperative.

"Reserves

"A serious commercial enterprise must constitute reserves for itself out of its annual profits. Some of these reserves (reserves for depreciation, for doubtful debts) are admitted as expenses for income tax purposes, while others are not. Whether they are or not, these reserves are nevertheless considered indispensable. The enterprise that would only set up the reserves admitted as expenses for income tax purposes would run the risk of facing bankruptcy with the onset of the slightest crisis.

"The cooperative like ordinary enterprise sets up reserves for itself. However, thanks to the special status bestowed upon it, none of these reserves, be they contingent or not, is subject to the Income Tax Act. The cooperative can by reason of this exemption set up for itself considerable reserves which enable it not only to cope with contingencies, but also to progress. In the meantime, private enterprise seeing its profits largely taken by the treasury, at the rate of forty per cent to eighty per cent, as the case may be, cannot think of the future.

"Tax-exempt reserves accumulated by the cooperative are of the same nature as the taxed reserves of capitalized companies. With the cooperative as with the company, those reserves belong to the shareholders and not to the clients in the ratio of their purchases.

"Section 39 of the Cooperative Syndicates Act of Quebec specifies in fact that such reserves will only be





distributed between the shareholders and auxiliary members in the event of dissolution. Section 29 of the same act specifies that in the case of credit syndicates the reserves will be distributed in the event of dissolution to benevolent undertakings designated by the Lieutenant-governor in council. This section of the act shows that the reserves do not belong to the cooperators as patrons of the cooperative and are not of the same nature as patronage dividends."

And that brings me to page 24:

"Return on Capital

"The return on ordinary or preferred capital stock in a cooperative society is generally limited to a nominal rate of interest. This return on capital is subjected, however, to the profits of the cooperative and there is no doubt that it must be considered as a distribution of profits.

"Conclusions:

"The cooperative must be taxed because it is an organization pursuing an economic end and which, though that is not its main purpose, derives a profit from transactions or at least from certain transactions it makes. When it deals with non-members, or when it gets an income from its investments, for instance, the cooperative undoubtedly makes profits. Even on transactions with its members, the portion of the profits it does not hand back to its members in the form of a patronage dividend constitutes a profit for it; this is clearly the case with reserves, surplus earnings and the return on capital."

Page 25:

"The cooperative must be taxed because it constitutes



an economic regime that tends to substitute itself in part at least for the capitalistic regime and which, to the extent that it succeeds, either decreases the revenue of the state or else increases the burden of taxes which ordinary enterprises and the other taxpayers must pay.

"The cooperatives must be taxed because it is not just that it may be able, out of its profits exempt from taxation, to set up for itself reserves which give it a marked advantage over heavily taxed capitalistic enterprise. The purpose of the cooperative is to cause a lowering of the price of goods and services; if it does so only to the extent that it is exempted from taxation, its intrinsic value is questionable. Any enterprise exempted from the present tax can lower its prices.

"The cooperative asks to be exempted from taxation because it is useful, because it is, in the case of the agricultural cooperative, a service organization or again because it educates its members. Without denying any of the parts played by the cooperative, we believe that they do not constitute sufficient reasons to exempt it from taxation. Ordinary enterprise too is useful; certain ordinary enterprises which neither buy nor sell on their own account (security brokers, commercial brokers, public accountants, etc., ) many commercial enterprises also undertake the education of the public on the use of their products and advise their customers on the way to use them.

"Recommendations:

"For the reasons set out in the preceding pages, the chamber of commerce of the province of Quebec recommends:

"1. that from the standpoint of the income tax and the excess profits tax, cooperatives be considered like joint stock companies;





"2. that patronage dividends or discounts distributed to the patrons of an enterprise (cooperative or not) in proportion to their volume of business, provided they be paid in ready money (or at least within a reasonable time), be considered as an expense."

And thus is the situation revealed by our inquiry.

BY MR. BROSSARD:

Q. Mr. Latour, I understand that a survey of cooperatism has been undertaken by two committees of your chamber one constituted in 1943 and the other in 1944?

A. Yes, sir.

Q. Have these surveys been conducted from the same point of view? Has the 1943 committee taken up the question of cooperatism from the point of view of taxation?

A. I shall have to be guided by my memory in my reply, and it may happen that an inquiry may be necessary in order to be more accurate, but I believe I reflect faithfully the trend of the debates which took place in 1943, if I tell you that this has constituted..... in the first instance, during the year 1943, there was some dissatisfaction in regard to cooperatives and then it was decided in order to dispel that dissatisfaction, in order to, at least as far as I am concerned, create friendly relations between cooperatives and private enterprises, it was decided, I say, to form in Quebec a committee composed of from fifty to sixty persons. This committee was simply instructed to give an opinion, or rather a direction to the provincial chamber as to the official attitude to be taken by the latter towards cooperatism. On this committee were Father Georges Henri Levesque, president of the Superior Council of Cooperation and many other members of the Superior Council of Cooperation, because it was our intention that every one who could be interested in this question should be present and should have



the opportunity of giving their opinion. The debate was most calm and most moderate although generally interesting.

Finally, the committee decided, in its report, in a general meeting, that cooperatives were excellent and that such or such cooperative, whose names I cannot now recall by memory, should be recommended but that, on the contrary, the question of taxation should be more particularly investigated; and secondly, the question of business transactions with non-members. Such is the trend of the report which was presented to the general meeting.

Q. Then, as far as the surveys undertaken by this first committee, no final decision was reached with regard to the attitude that the chamber of commerce should take towards the cooperatives in question?

A. The committee did reach final conclusions and did recommend to approve of a certain class of cooperatives and to investigate, however, two or three special problems concerning cooperatives, but, at the general meeting, this was blocked.

THE CHAIRMAN: Q. You were unanimous in recommending that certain classes of cooperatives should be approved of?

A. Yes, the committee was fairly unanimous, but at the general meeting, that was blocked.

BY MR. BROSSARD:

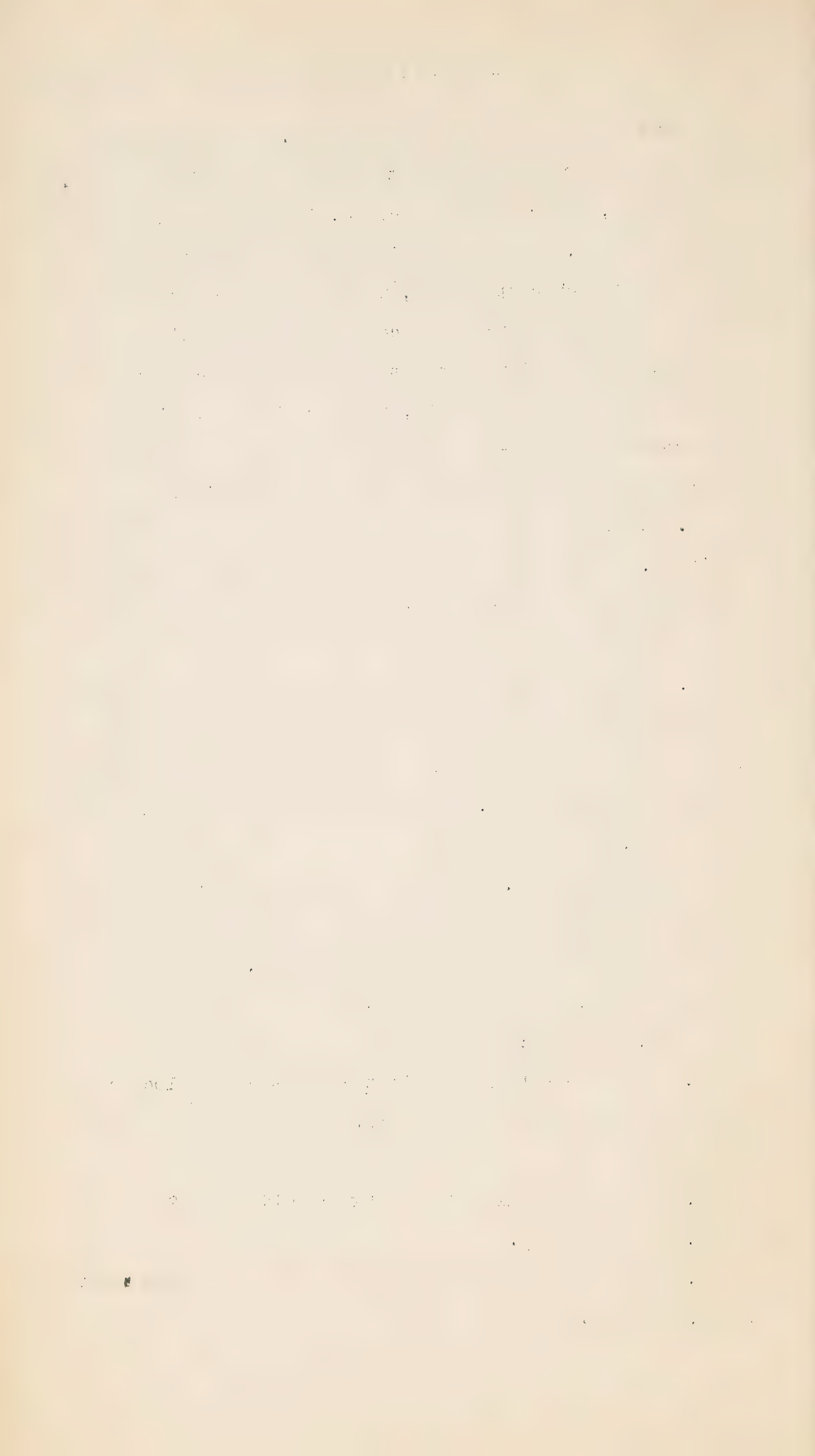
Q. So the report of the first committee was blocked at the general meeting? A. Well, that is to say that a change was made.

Q. That matter was deferred for consideration?

A. That is right.

Q. And this is the result of that first consideration?

A. Yes, exactly.



Q. You said a little while ago that there was some dissatisfaction among the members of the chamber with regard to the cooperatives? A. Yes, sir.

Q. In what respect? A. With respect to taxation.

Q. That was the chief complaint, that matter of taxation? A. Yes, that was the chief complaint.

Q. What were the cooperatives which met with the unanimous approval of the chamber?

A. Of the chamber, well, there were not any.

Q. I am not asking you to give us the names of the particular cooperatives, but what was the character of those cooperatives? A. I told you a moment ago that the committee had decided to recommend certain cooperatives, but that the general meeting did not agree, and the amendment made by the general meeting was to transform or change the word "approve" into the word "consider".

Q. Then, it can be said that up to the end of 1943, amongst the Federation of the Chambers of Commerce, there was not only a lack of unanimity, but even a great difference of views with regard to the attitude to be adopted towards the cooperatives? A. Quite right.

Q. And in 1944, you appointed a new committee? A. Yes.

Q. Which also made its report, after considering the question, at the general convention, to confirm it? A. Yes.

Q. Were the findings or recommendations of that committee approved unanimously? A. They were approved unanimously by the meeting.

Q. What were exactly those conclusions? A. The meaning of those conclusions?

Q. The meaning of those conclusions? A. The meaning





of those conclusions was that the cooperative had to be placed on an equal footing with the ordinary private enterprise in the matter of taxation.

Q. It is after the report of the committee was carried that you were requested to prepare a brief?

A. No, a Royal Commission had not been authorized at that time, then it was later; the decision of the Federation of Chambers of Commerce is anterior to the appointment of the Royal Commission of Inquiry on Cooperatives.

Q. You prepared your brief in or around February?

A. Yes.

Q. Would you please tell us when you communicated this brief to the various members of the Chambers of Commerce?

A. We are still receiving replies every day, and as a matter of fact, this is the reason of the corrections I have just given you.

Q. This is why I am asking you this question, because I have noticed that since you submitted your brief to the Royal Commission of Inquiry on Cooperatives you have received five other replies?

A. Yes, sir.

Q. So it is possible you may receive more?

A. Well, the member-chambers have already had from three weeks to a month's time to reply.

Q. In your request to the member-chambers, did you call their attention to the need and the advantages for them to send you a reply, whatever it may be? A. It was this way, we sent them a letter referring to the brief, and in our letter we made no attempt to influence their decisions, but we said this: "We consider that this question is important, and in fact, should less than one-third of the chambers be opposed to the brief, the brief shall be deemed approved." This is in accordance with our



Q. But you made that remark in the circular letter you sent to the member-chambers? A. We sent two letters in order to get two replies.

Q. You did not tell them that if a chamber did not reply, its abstention might be considered ..... A. No.

Q. As an approval of the brief.

A. No, we drew their attention to the by-laws, we did not tell them that their silence would be considered as an approval, and we do not pretend it is either.

Q. Can it be taken for granted or not, as regards the forty-two chambers which expressed no opinion, either that they are not interested or should it be taken for granted that fact is favourable or unfavourable to your brief?

A. That is a question of personal opinion; I can give you my personal opinion, but I cannot say anything definite.

Q. It may be valuable.

A. Well, it is due to the fact, from what I noticed in some places I visited personally, that certain chambers expressed no opinion because they were afraid of reprisals.

Q. They were afraid of reprisals from whom?

A. From the cooperatives, because, you see, quite a number of those chambers are located in small districts; in fact, most of those which did not answer are located in small rural districts, and they were perhaps in a position which made it difficult for them to speak their mind. And they are made up partly, I believe, of farmers, former farmers, retired gentlemen, merchants, farmers and people like that.

Q. And that would be the reason why a good number of the member-chambers of the federation refrained from revealing their opinion to you? A. I think so; you see, it is because some chambers of commerce, the membership of which is mostly made up of farmers, were in favour of cooperatives, and the





merchants were against, naturally, but just the same, the merchants did not want to lose the farmers' trade.

Q. Among the twenty chambers which approved the brief without any remark, do you know if the members of these various chambers were unanimous about it?

A. I could not say, I have no figures on it.

BY THE CHAIRMAN:

Q. The interest shown was very general? A. We tried to raise a very wide-spread interest, and it is chiefly after the Chamber of Commerce of Montreal had submitted its brief before the Commission that we decided to get people interested because there had occurred transgressions we did not like.

Q. At any event, out of the eighty-two chambers, only thirty-five have expressed their opinion? A. Yes.

Q. And five have stated they wished to abstain from expressing an opinion, and the balance of forty-two chambers simply did not reply? A. Yes.

BY MR. BROSSARD:

Q. And yet, in your list of forty-two chambers, I notice Rouyn, Noranda, I am under the impression they sent you their opinion? A. No, it was Val d'Or.

Q. Oh, excuse me, it is La Sarre? A. Yes, it is La Sarre which sent us one, yes.

Q. Are these member-chambers of your federation?

A. Yes, sir.

Q. From the consensus of opinion expressed by your member-chambers, it would follow that there is a split in the midst of the federation on that matter?

A. Well, it is an expression of opinion of the majority of each of the interested chambers, and it is the official consensus of the federation.

Q. When you speak of official expression of opinion



of the Federation of Chambers of Commerce of the province of Quebec, does such a decision actually represent the opinion of the majority of your members? A. We have seen the Liberal Party in the Province of Quebec polling the majority of the votes and yet not holding office.

Q. What you have just said is one of the reasons of my question; precisely, you have the majority of your members who tacitly have expressed their approval, but I would like to know if their number corresponds actually to the majority of your members? A. I could not go as far as that, truly that would be going beyond my mandate.

Q. Would you have any objection to file a copy of the constitution and by-laws of your Chamber of Commerce?

A. Not at all. Would I be allowed to add one word, gentlemen, please?

Q. Go on. A. The constitution and by-laws of the Federation of Chambers of Commerce are so established that they protect the minority; as a matter of fact, one third of our chambers opposed to a certain matter is sufficient for its non-adoption; this was done in order to off-set the undue influence of the large centres with regard to the small centres, we have tried to neutralize such an influence by giving the right of veto to a minority of one third of the chambers.

Q. Then am I right when I say that the chambers established in the large industrial centres were favourable to your recommendations? A. In my opinion, it is an interpretation we have no right to give.

Q. On page 11 of your brief, you state among other things: "The price is made up of the cost of the service, the profit and the tax"? A. Yes.

Q. Is that entirely true, Mr. Latour? A. I would



like you to show me the contrary.

Q. When you set the sale price, do you take the tax into account? A. Absolutely, it must be taken into account.

Q. For what purposes? To determine the amount of profits to be realized? A. With the system of "excess profits" we now have, it is interesting up to a certain extent, because it is possible to determine what will be the average total profit, above the said amount it is not interesting for a business man to try and realize profits.

Q. Have you to take the tax into account for the setting of the sale price? A. Yes, for the volume of business.

Q. For the volume of business and indirectly for the net profit that the enterprise may realize?

A. Well, I would make one distinction, I said, I say that, in political economy, the sale price, the prices that one is requested to pay have to be determined in advance. In political economy, the sale price is determined by the necessity of survival of an enterprise; that is established by its expenses, the profit that one has to realize to survive, so that it is worth while to maintain the enterprise; however, it is not the physical price asked, the price must be in accordance with the value of the services rendered and it must be a price that is satisfactory in relation to the work.

Q. It is to that price that you refer, it is in that price that you include the tax? A. Yes, it goes in mathematically, you do not figure it in advance, but it is included.

Q. It is part of it after the sale, not before?

A. Exactly, we did not say that it was part of it before the sale.





Q. But it is after the sale that the tax is part of the price? A. Exactly.

Q. But you could just as well sell your goods without taking that factor into account, if you were not interested in advance to the net profit that you may realize?

A. No, it is impossible, it is not taken into account, but in the nature of things, in the essence of things, it is what makes one thing what it is, so in the price of an article, the tax is part of the essence of the price, it is one of its components, it is one of its components in the matter of taxation.

Q. Mr. Latour, if you would eliminate entirely the profit factor and take into account only the cost of the service? A. Yes.

Q. Would the tax be taken into account? A. Yes, necessarily.

Q. You have taxes generally and the income tax? A. Yes.

Q. On page 11 of your brief, when you speak of tax, you do not refer to income tax, you speak of taxes in general, all sorts of taxes? A. Yes.

Q. In a general way? A. Yes, of all sorts of taxes, referring to political economy ...

Q. But you include also the income tax? A. Exactly.

Q. What I would like you to admit is this: Is it possible and it may be true that income tax is a constituent element of the sale price ... A. It is a posteriori.

Q. ... that you take it into account before the sale only pari passu with the profit to be realized?

A. Well, it would depend on the nature of the enterprise, that question could be discussed for hours and days without coming to an agreement, it is a question of enterprise and



of allocation of cost of service, for it is admitted, in business, that a lower price is asked or may be asked for a service which in se is more expensive; it is a question of equilibrium, that has been admitted for a long time.

Q. And, generally speaking, it is true, in political economy, that the tax is included in the price, but a posteriori only?

A. Exactly.

Q. Now, on the same page, you say: "In these times, the business man is convinced that he works for the state"?

A. Yes.

Q. I suppose we could replace the word "state" by "public weal", it is the same thing? A. If you want to, it is the state, for the community, if you prefer, for the public weal, for the community, I would prefer that expression.

Q. May I add that you admit that private enterprise has a social function to fulfill, also, in saying that.

A. Yes.

Q. On page 12 of your brief, I find the following general assertion: "That the cooperative competes with private enterprise"? A. Where did you say it was?

Q. On page 12, at the second paragraph, you say: "However, a form of enterprise was set up alongside. In appearance, it has all the characteristics of an ordinary enterprise. It is submitted to the same economic laws. It competes with it". Could you tell us to what extent, in the province of Quebec, as you are speaking on behalf of the Federation of Chambers of Commerce of the province of Quebec, cooperatives compete with private enterprise?

A. It is a matter of type, that will have to be analysed: I know that in certain fields, cooperative is gradually becoming a trust, and I could quote one example, the butter and cheese factories in the province of Quebec.





They have exceeded, I think I can give you the figure by memory, sixty per cent of the total production; it is a tendency, an increase over a period of ten years, which is ever increasing, it is a very important factor. As a matter of fact, you see that our butter and cheese factories, more often than otherwise, are in the cooperative field, it is an elimination process, the private enterprise is eliminated.

Q. But, did such an elimination of the private enterprise result from the unfair competition of cooperatives, or is it due to the fact farmers and producers simply did get together, did organize cooperatives for the sale of their products? A. I believe that is really to the advantage of the farmers of the province of Quebec that cooperatives have done so.

Q. Is the elimination of the private enterprise due to the cooperative methods used, or was that done on account of one possibility, as far as cooperators are concerned, the possibility of selling their products at a better, at a higher price, as the case may be? A. In political economy, when one agency replaces another agency, it is because it was necessary; if there is no need for it, there cannot be any agency, now, this need results from an unfavourable state of things, then, if there are any advantages to become co-operators, either because the government gives grants, or facilitates the sale or provides certain advantages ....

THE CHAIRMAN: Mr. Latour, would you speak louder, please?

THE WITNESS: Yes. I said that in political economy, an agency exists because it is created by a need in view of securing a better result, of attaining a better state of things, then the need for the farmers to get organized in cooperatives results from the fact that the government, in the case of



the butter factories, for instance, helps them to modernize their butter factories, gives them grants, makes the inspection, gives courses during the winter months, and I could add, grants tax exemption; it is true that with regard to taxation, the tax element does play a vital part, at least, I do not think so, but it is on account of the abovementioned reasons that there are advantages for the farmers to organize themselves into cooperatives.

BY MR. BROSSARD:

Q. That is why, a moment ago, I asked you if you could tell us that in the province of Quebec there was substantial competition on the part of the cooperatives?

A. In that field, yes, always.

Q. In other fields, in the consumer cooperative field, was there or is there substantial competition on the part of the cooperatives with the private business, the private enterprise? A. I think that in the province of Quebec, certain cooperatives succeeded in grouping themselves because the private enterprise was taking an unfair advantage of the situation.

Q. Mr. Latour, have you an idea of the total amount of business of the consumer cooperatives in relation to the total amount of business of private enterprises?

A. Offhand, no.

Q. Have you any idea, as far as taxation is concerned, what would represent the taxation of profits realized by cooperatives, whatever their category, on the same basis as the taxation of private enterprises? A. I heard the amount of one hundred millior dollars mentioned for the whole of Canada. I have not the proof of it.

THE CHAIRMAN: As far as the province of Quebec is concerned, you have no figure?

THE WITNESS: No, sir.



Q. As far as Quebec is concerned, you have no figure?

A. No, sir.

THE CHAIRMAN: That figure of \$100,000,000 was born in the west, Mr. Fillmore, and still remains with us.

BY MR. BROSSARD:

Q. In many instances, you mention profits and you assimilate the profits realized by cooperatives to those realized by private enterprise? A. In so doing, I commit the same offence committed by the Quebec legislator. because all through the cooperative acts, agricultural societies act and cooperative act, they refer to profits; they commit the same offence.

Q. Do you make a distinction between the profits realized by a cooperative and those realized by private enterprise? A. We do not make any distinction in our brief as far as patronage dividend is concerned, we state that under existing conditions the patronage dividend is not a profit within the meaning of the Income Tax Act.

Q. You even go further and state that provided, also, the patronage dividend is paid within a reasonable time, it should not be considered as a profit? A. Yes.

Q. What do you mean by within a reasonable time?

A. Well, it is like this; at a general meeting, a cooperative may declare a patronage dividend of "X", for instance, and state: "We will pay the members the patronage dividend "X". Then the amount "Y" will constitute a loan, and that is decided by the majority of the members. Then the amount "Y" becomes capital for the cooperative, and that is what we want to avoid, because we maintain that by doing so, that amount becomes a profit; for there is a change of nature, it is no more a patronage dividend because the patronage dividend is an overpayment on a surplus on operations, for a





certain period, for a certain year. Then if all the necessary reserves have been provided for and a patronage dividend is declared, that means that the said amount is a surplus that is not needed; then if a patronage dividend is declared, you say I do not need this or that, but I will keep a portion that you will lend me. Consequently there is contradiction in the terms. If you say: "I may not need this for the present but I foresee that I may need it later on, then I ask you immediately for the overpayment, for the profit and request you to lend me a portion of the amount I am disposed to give you, in case I may need it later on". Then, there is a change, a change of nature, it is another matter altogether. ....

BY THE CHAIRMAN:

Q. Would it not be possible to divide the patronage dividend into two parts; the loaned-paid part and the paid part? A. Well, if a cooperative deals with non-members, there is a profit.

Q. Even if a cooperative is dealing with members only, is there not an element of profit? A. If it is not entirely distributed, yes.

Q. For instance, the return on investments? A. That is profit.

Q. That is profit? A. Yes.

Q. And that is included in the patronage dividend? A. Exactly.

BY MR. BROSSARD:

Q. Mr. Latour, in your brief, there is criticism and that criticism is based on an excerpt of an article of Mr. Descoteaux, Mr. Romeo Martin, Mr. Renald Ferron, published by the Department of Agriculture of the province of Quebec. Is that an official publication of the Department of Agriculture?



A. I don't know what distinction is to be made between an official and an unofficial publication; I know it was published by the Department, but ....

Q. It was published by the Department of Agriculture?

A. Yes.

Q. In booklet form? A. Yes, in booklet form, and that is why we assimilated it to a previous official text.

Q. But does it express the opinion of its authors or the opinion of the Department of Agriculture? A. No, not of the Department, at least I don't think so.

BY THE CHAIRMAN:

Q. Do you believe it is possible to break up the patronage dividend into those two separate elements, the real profits and the cost? Do you see any way to do it?

A. From the accounting point of view it might be done, but I am speaking for the province of Quebec, cooperative accounting is rather funny just now; the movement has grown a lot in the province of Quebec.

Q. Though only in the last five or six years, is it not? A. Yes, what happened is that cooperative promoters do not pay themselves big salaries; they go all over the province to improve accounting methods, their own accounting methods, and consequently they are methods which are introduced gradually; they are now at a stage where it is not possible to make any distinction, except roughly.

BY THE CHAIRMAN:

Q. The distinction is perhaps possible? A. Well, it may be possible ... I want to state publicly that, personally, I am very sympathetic to cooperatives.

THE CHAIRMAN: So is everybody.

BY MR. BROSSARD:

Q. Am I right in inferring, from some statements by





which you concluded your criticism of the article I mentioned a few minutes ago, that what you hold against the cooperatives in their idea of selling at cost, is trying to put the interest of their members before the interest of the consumer?

A. Not trying to look only after the interest of their members, because it is said first of all that private enterprise has a social purpose, and one wants it to be a private enterprise, but one wants it to be social as well, so ...

Q. And not sell at any other price than the current price? A. Yes. Well, any price decrease benefits mankind.

Q. Anyway, your contention is that up to now the cooperatives have been more interested in the welfare of the members than in the welfare of the consumers?

A. Yes, and far from me to blame them.

BY THE CHAIRMAN:

Q. I understand it is the moral aspect of the thing we must consider now? A. Yes, it is the moral aspect; now that has been mentioned several times during the inquiry which took place.

Q. But the good citizens must pay taxes as well as the bad ones? A. Yes, sir.

Q. No distinction should be made? A. No, but it would be as well to give explanations to certain groups, for instance.

Q. I believe that all those who do not like the fact that cooperatives are paying no taxes, would be very satisfied if, instead of being granted that tax exemption, cooperatives were granted every year a subsidy to improve their position? A. Ah! ...

BY MR. BROSSARD:

Q. On page 18 of your brief, you state the following: "If the cooperative could, without being exempted from



taxation, sell more cheaply than its competitors, that would not be exasperating in any way; what is exasperating is that it can do so because it benefits by preferred treatment in the form of tax exemption,"?

A. Yes.

Q. You seem to claim by this that the cooperative actually undersells its competitors because it is tax exempt; is that what you mean; is it what you mean or do you claim that it could, if it wanted to, undersell its competitors?

A. The conditional mood is better.

Q. Then how could tax exemption enable the cooperative to undersell its competitors? A. This way; your tax is part of your profit, is it not?

Q. Yes, it always amounts to that. A. It is part of your profit, and, so if the cooperator joins only in order to enjoy benefits, interest is the motive of all human actions for everybody, cooperator, merchant, manufacturer or anybody; so, they join a cooperative to enjoy its benefits; but part of these benefits is exactly to get service at lower costs, either through a patronage dividend or a better sale price; and here is what happens; if the cooperative sells exactly at cost, it runs the risk of endangering its existence, because it will have no reserve to face a crisis or an unlucky transaction. A crisis, indeed, or an unlucky transaction may ruin the cooperative altogether. So the cooperative sells at the current price and has a margin which it hands over to the members of its organization. But what will happen if a tax is imposed; if you tax the cooperative, if you tax it the same way an ordinary enterprise is taxed, well, that is so much less money it will be able to give its members, so much less service it will be able to render its members; perhaps a truck it will not be able to buy



for fetching and carrying goods, perhaps an additional telephone which might be necessary and which cannot be had, or yet a diesel motor which could be purchased in order to save electric rates and which it will have to do without; and this is the exact position of a company; for a company, that is profits.

Q. But you merely suppose that this could happen?

A. No, I do not suppose it.

Q. Well, you used the conditional mood a moment ago; you said that the cooperative could sell more cheaply than its competitors? A. Well, it is because it is not actually admitted that they sell more cheaply than the others.

Q. Therefore, up to now, it did not enter into unfair competition with private enterprise? A. But, I do not claim that competition is unfair, it is competition, nevertheless; they enjoy advantages that others do not enjoy, but this is not unfair competition, because it is done openly.

BY THE CHAIRMAN:

Q. It is the privilege that would be unfair?

A. Plague on the disappearance of the privilege.

Q. But, that is sound competition? A. Certainly, besides, competition is an element of our system, for if there is no competition, you would have a shocking abuse, the most shocking dictatorship.

BY MR. BROSSARD:

Q. On page 23 of your brief, you say this: "Tax-exempt reserves accumulated by the Cooperative are however of the same nature as the taxed reserves of capitalized companies."

A. Where is that?

Q. On page 23 of your brief, second paragraph: "Tax-exempt reserves accumulated by the cooperative are however of the same nature as the taxed reserves of capitalized companies."





A. It was learned at the outset that a principle had been laid down to the effect that there was a difference between the cooperative and private enterprise. With regard to the privileges that are granted to one and which prejudice the other, the method of distributing their profits, and so on; then, if this is laid down as a principle, all the other elements which are similar, should not be discussed. So, here is what happens; in order that the reserve of a cooperative be different in nature from that of an ordinary enterprise, that reserve of the cooperative should be owned not by the cooperative but by Mr. "Y", Mr. "X" or Mr. "Z".

Q. But, is not that the case? A. Of course, it is not so, that reserve does not belong to the cooperators as purchasers, it belongs to the cooperative, to a third person, call it as you like, cooperative or otherwise.

Q. But, it seems that the ownership of the members is emphasized? A. All right, as shareholders and not as cooperators.

Q. As members of the cooperative? A. As shareholders of the cooperative.

Q. But, between the shareholder and the member of the cooperative, you do not make any distinction?

A. There is no distinction made, I agree that member and shareholder of the cooperative are synonymous; but, here is how it works, I am very well acquainted with a member of a cooperative, he is a member of the cooperative, and he is a member say to the extent of a fifty dollar share of the capital stock, but he never bought from the cooperative, for one reason or another, but still, he never bought from the cooperative, because it was not convenient I suppose. But, comes the time when that cooperative has accumulated reserves, and a general meeting is called, and at this



general meeting, the member in question votes and receives from the cooperative as much as the one who buys ten thousand dollars worth. Then, that member, who never bought from the cooperative, but who holds a fifty dollar share, because he is a member of the cooperative, will get as a matter of fact part of the reserve in proportion to his fifty dollars, and not in proportion to his purchases from the cooperative, and in that case the cooperative has decided that he will have five dollars, for instance, while the other member who also holds a fifty dollar share, but whose purchases amount to ten thousand dollars, will participate only in proportion to his fifty dollars. That is the basic distinction that has to be made.

BY MR. BROSSARD:

Q. Would you make a distinction between the reserves set up in the manner you just explained, and those that could be built through loans made personally by each cooperator in proportion to his volume of business with the cooperative? A. There is undoubtedly a distinction to be made.

BY THE CHAIRMAN:

Q. But, the reserves of both are capital?  
A. They are part of the capital qualitatively, but not as capital stock.

BY MR. BROSSARD:

Q. Once more, we are coming back to our former idea; on page 25, second paragraph, you say: "The purpose of the cooperative is to cause a lowering of the price of goods and services; if it does so only to the extent that it is exempted from taxation its intrinsic value is questionable"?  
A. Yes.

Q. Again, up to the present time, the cooperative





has not lowered the price of goods on account of its tax exemption? A. Listen, Mr. Brossard, it did not physically, as cooperators, as an individual who receives say for instance, for the sake of argument, two dollars and twenty-five cents more, but what has occurred is that that cooperative, by being exempted from taxation, has been able to distribute its capital in another way, and to buy a tire, for instance, a truck with which it can go directly and get vegetables on the market, and bring them back and sell them more cheaply, due to the fact that it has eliminated the expense, because the interesting thing for a cooperative in respect of consumption policy, is that it can foresee the volume of products it will sell, and so, it can, still by means of the same system, place a girl at the telephone to canvass customers, and thus be in a position to say: we need twelve or fifteen cases of tomatoes, for instance, but if you could not have a girl to telephone, to know in advance what you require, you might go and buy twenty cases of tomatoes, which would involve a loss.

Q. Then, I think your opinion could be summarized as follows: With regard to the amounts the cooperative applies to the reserve, they should be realized in the same way as those of the private enterprise?

A. Yes.

Q. And with regard to the amounts which are not applied to the reserve and are distributed in any way, you maintain that they should not be taxed?

A. Except if the patronage dividend becomes a loan and I may add this if I am allowed: If the cooperative enjoys a tax exemption enabling it to reduce its prices, the same privilege should be extended to any other enterprise so it could stand the competition. You see, normally,



the enterprise realizes profit and it figures at the beginning of the year that provided the profit does not exceed five thousand dollars it will not have to pay any excess profit tax; then it will tell its members, if my turnover exceeds such an amount, a patronage dividend will be paid out of that surplus. Then, for instance, it realizes \$100,000 of excess profits, the said profits are divided between its members and its customers, which are members, evidently, instead of being given to the government, Well, that is not right; that is what happens and that is how it is possible to reduce the prices.

Q. I come to your conclusions. A. Yes.

Q. First conclusion: In the matter of income tax and excess profit tax, cooperatives should be considered as joint stock companies? A. Yes.

Q. You agree, however, that amounts paid as patronage dividends should not be taxed? A. We maintain that within the meaning of the tax as it is now, that within the meaning of the definition of profit, the patronage dividend is not a profit and, consequently, cannot be taxed.

Q. Then, what portion exactly of the profit of a cooperative would you tax, when you ask that they be put on the same footing as joint stock companies?

A. By eliminating the special provisions of the Income Tax Act, by striking out these sections and by putting the cooperatives automatically, on the same footing as the joint stock companies, the former could not realize a profit on the patronage dividend, so that the joint stock companies would have the same opportunity, as the cooperatives, to realize profits.

Q. So, on the one hand, you would like to raise, you would like to lower cooperatives to the same level as joint



stock companies, and, on the other hand, you would like joint stock companies to enjoy the same privileges as cooperatives?

A. I mean that when one interpretation of the act is given in favour of cooperatives, the same interpretation should apply to private enterprises for, as you know, certain discounts are allowed and some are not; then, according to jurisprudence, or what is called rulings, in certain cases an exemption is allowed and in other cases it is not.

BY THE CHAIRMAN:

Q. Mr. Latour, you have noticed, did you not, that in the province of Quebec, as anywhere else, there are real cooperatives, what we may call genuine cooperatives, for there are some that are not?

A. That is true.

Q. You have noticed it in the province of Quebec as it was noticed elsewhere? A. That is true.

Q. Then, according to you, what are the essential principles of cooperation? A. I think that the main principle which characterizes cooperatives is not so much the subscription of capital, it is secondary, because a capital can easily be constituted out of the purchases and patronage dividend, that is important; it is the representation at the general meeting, one man, one vote, and the redistribution of profit; if that is done in a democratic way, as it is done in a democratic country, that is to say if the best man is governing, it is all right.

BY THE CHAIRMAN:

Q. Have you ever heard of the revolving door, the way that the patronage dividends are distributed?

A. I am not aware of that, I have a certain notion, but ...

Q. Is that what we may call a real cooperative?

A. No, it is not a real cooperative.





BY MR. NADEAU:

Q. Would the principles of real cooperative as you just summarized them, apply, for instance, to cooperatives in the manufacturing field? A. Certainly, and that exists somewhere else.

Q. In the same way? A. Yes.

Q. You would apply the same principles to a cooperative manufacturing butter boxes, farm implements, motor cars and what else? A. Certainly.

Q. You would apply the same principle? A. Yes, I would apply the same principle.

Q. In the province of Quebec, what competition can cooperatives institute in the farm products field, to a wholesale enterprise, a wholesale distribution enterprise? A. A serious competition.

Q. Have you any figures showing the proportion of cooperatives business and the proportion of business of other concerns? A. We have some figures, they are almost complete; they show a tendency, that is all that we can derive, they show tendencies; we have noticed that co-operatives, in the farm products field, were forging ahead by restricting the development of other concerns.

Q. Do those cooperatives accumulate large reserves? A. Certainly, and moreover, it is the opinion expressed by one of those who signed the text I referred to, I could not say it is now, but nevertheless, he expressed himself as being in favour of cooperatives being real cooperatives, and they all agree on one point, at least, that the tax should be paid, that it is rational to pay income tax, but they insist on one point, that a reserve should be set up, because if there is no reserve, it is impossible to increase, to improve the business and it creates a difficult or even



a dangerous position, and then when reserves are set up the tax is paid.

Q. Do you agree that a cooperative should have a necessary reserve free from taxation? A. Surely, where the cooperatives are wrong is in not being specific enough as to the reserve; it is always the question of improvement of the accounting system and of the control which is defective. For instance, they should specify income tax, putting aside a reserve for depreciation of such machinery, plant or factory, of such and such order, but the report must show specifically, when there is money in the case box, a certain amount for the general reserve, and a certain amount for such and such reserve.

Q. You maintain that that reserve should be submitted to a control? A. I maintain that that reserve should be submitted to a control; we must agree, up to a certain extent, that the cooperative should enjoy income tax exemption for specific reserves, not as far as the members are concerned, and that the amount should be specific and exact.

BY THE CHAIRMAN:

Q. In some provinces the amount is specified very accurately? A. Then I have no objection; I am speaking of the province of Quebec.

BY MR. NADEAU:

Q. Cooperatives in the province of Quebec have no local reserves anyway? A. No, there is only a general reserve.

Q. When you speak of patronage dividends which, in your opinion, cannot be taxed if they are paid in cash, are you thinking of the patronage dividends which, normally, should be paid to the non-members of a cooperative?

A. The profits of these non-members are supposed to be taxed.





Q. You suppose that the profits made by these non-members are taxed? A. Yes, because otherwise it is not justifiable. The text mentions that these profits are real profits and we conclude that it is so because we believe it was necessary to have it considered as such.

Q. I am pointing this out because you do not mention it in your conclusions? A. No, but it is mentioned in the text.

Q. What is, in your opinion, the position of a stock company, as regards its general reserve for development?

A. For new enterprises, the recent ones which started what is commonly known as the depression, conditions are not very bright; they are in the position of being unable to expand, as actually they cannot set up sufficient reserves to protect themselves, and their reserves are getting smaller all the time.

BY THE CHAIRMAN:

Q. Are you familiar with the term "contingency reserve"?

A. Yes, reserve contingents, it is a general reserve which is not admitted unless it is specified.

BY MR. NADEAU:

Q. You see, Mr. Latour, the commission has often heard the same argument about reserves of ordinary stock companies being reduced more and more, but unfortunately we have not been given very much proof of it. Are you in a position to produce that proof? A. By proof, you mean actual cases; it is very embarrassing to submit cases; it can be done but you can imagine the consequences it may have; personally, I know for a fact that our business men, in our enterprises, I am not speaking of French-Canadian circles only but of all the others, have to resort to somewhat unorthodox methods, either overestimation or something else in order to endeavour



to survive. Now, you understand as I do that it is not easy to mention names.

Q. It is not a question of mentioning names but of appraising general conditions by selecting a few specific types of business and analyzing the position from the point of view of reserves. Would that be possible? A. It is possible to make a study of a given business in a given field; for instance one could write a monograph on foreign trade, but that would not prove anything; it would have to be done in a familiar field in order to establish an average with related factors.

Q. So that you do not think it is possible to prove to us that stock companies are in a bad way compared with cooperatives? A. Not unless you accept a statement from some authority. Ah! if you summoned before you the Society of Chartered Accountants, for instance, they would make an investigation among their members and they could make a sworn statement, subject to professional ethics, and you may be able to see a trend, but you will not get any concrete fact. I know of many concrete cases, but I have no right to tell you about them.

Q. You are not being asked either. Regarding patronage dividends which are not paid in cash, my colleague, Mr. Arnason, would like to have your opinion on this: The patronage dividend is not paid in cash, but is included in the taxable income of the cooperators who afterwards lend the amount of the patronage dividend received to the cooperative. Do you think that that patronage dividend should be exempt from taxation before it is paid by the cooperative? A. Do you mean that if an amount of patronage dividend say of ten dollars has been granted, of which five dollars is



paid out in cash while the other five dollars is a loan, the person receiving it would be obliged to pay full tax on that.

Q. Yes, that is right.

A. Well, that amount would have to be determined, it would have to be large enough to be declared. If it is a consumer, a farmer, for instance, you know that, the revenue of our farmers being what it is, there are very few cases where they would have to declare it that way, but there is no doubt that that case should be considered as the tax of the professional and that only the collection and not the revenue should count.

Q. Are you an accountant by profession, Mr. Latour?

A. No, I am a graduate of commercial sciences; master of commerce.

Q. What time would you give a cooperative to pay its patronage dividends?

A. It all depends on the membership. At the end of the fiscal year...

Q. You hold a general meeting, then let us say a month or two after the general meeting?

A. Yes.

BY THE CHAIRMAN:

Q. But in the very same year? A. Yes.

Q. Or the next year, if it is at the end of the year?

A. Yes.





(Ottawa, April 13 -- following French)

THE CHAIRMAN: Mr. Fillmore, would you like to cross-examine the witness?

MR. FILLMORE: Yes, my Lord. Although I am supposed to belong to a learned profession, I must confess my ignorance in modern languages. I hope Mr. Latour has a better education than I have.

BY THE CHAIRMAN:

Q. Can you answer in English? A. Well, sir, I will have to ask for your protection, because the question of shades of meaning may come into it.

MR. FILLMORE: I am not going to be very long, and if I cover ground that has been covered already I trust that you will stop me in my tracks.

Q. I see, Mr. Latour, that you recommend that patronage dividends should be allowed as an expense? A. That is right, sir.

Q. Were you referring to producer co-operatives as well as to consumer co-operatives? A. Any co-operative, whatever they call themselves, as long as they are co-operatives.

Q. I see you take the position that a co-operative is a corporation? A. Yes, it is.

Q. And that it can own property; it can buy and sell, and it can make a profit?

THE CHAIRMAN: He stated that.

MR. FILLMORE: I gathered that from the brief.

Q. Take the case of a consumers' co-operative which pays the current market price for the goods. It takes delivery of the goods, and the identity of the goods is lost; they become the property of the co-operative. The goods are manufactured; they are sold to the public. At the end of the year they make up a profit and loss statement, and they find



that there has been a profit. Then the directors of the co-operative meet and decide that they will distribute that profit, so much as reserve and so much among the members. Would you say that any part of that profit should be allowed as a deductible expense for income tax purposes? A. Well, first of all, sir, you have not described to me exactly what is a co-operative. You have described a company, because that surplus, that patronage dividend or whatever is to be distributed or returned to the reserve, should be acted upon by the general meeting of all the members.

Q. All right; let us say that all the members meet. At the end of the year we will say the company has a profit of \$1,000. That is either a profit or not a profit, is it not? I mean, you admit that a company can make profits; and you have a profit. Does it change the character of that profit if you divide it up in different ways? A. It most certainly does.

Q. You say, then, that the method of distribution should determine whether money is taxable or not? A. Of course.

Q. And that principle, you would say, would apply only to a co-operative and not to a joint stock company? A. I am not saying that. We contend that it should apply to a joint stock company, too.

Q. Your view, then, is -- A. We are not against the co-operatives. We want all to be treated alike.

Q. Then you say a joint stock company should also be allowed to make that patronage dividend and charge it up as an expense? A. Yes, sir.

Q. So they would both be on the same basis? A. That is right.





THE CHAIRMAN: That is, deal with the surplus in the same manner as a co-operative?

MR. FILLMORE: Yes.

Q. Then would you still consider that fair competition?

A. Sure. That is liberty. You can join a co-operative if you want to, or not.

Q. All right. Let us take things as they are now. We have two companies in a competing business. One is a co-operative and the other is the ordinary joint stock company. The co-operative takes its profit and divides most of it, we will say, among its members as a patronage dividend. Then the joint stock company, to meet that competition, takes the same proportion of its profit and divides it among those from whom it purchased goods. What does that leave for the shareholders of the joint stock company? A. It is up to the shareholders to decide for themselves.

THE CHAIRMAN: They own the company.

BY MR. FILLMORE:

Q. Well, let us say, then, that the shareholders -- are they not in a dilemma? In the first place in order to meet the competition they have to pay the customers the same as the co-operative does. If they do not meet the competition, if they take the money themselves, they lose business.

THE CHAIRMAN: Do you mean that imposes on the stock company an obligation to use a part of its surplus to offset what the co-operative does out of its surplus?

MR. FILLMORE: What I mean is this, my Lord. We will say that a joint stock company can make a patronage dividend and charge it up as a deductible expense. That is the proposal of the witness.



THE CHAIRMAN: You say they can do that. They cannot, at the moment.

MR. FILLMORE: No, my Lord; but I am just talking about Mr. Latour's views. His view is that both kinds of companies should be at liberty to pay patronage dividend and charge it as an expense in the profit and loss account.

THE WITNESS: Do you want me to discuss this point? I would be interested in discussing it very shortly. You are putting me in this awkward position, to be frank, that I am representing the Chamber of Commerce --

BY MR. FILLMORE:

Q. Just a moment. What I want to ask you is this. Supposing that condition prevailed; would not the shareholders of the joint stock company be in a very awkward position?

A. Now I will tell you something. There is a misconception at the very basis of your discussion, and it is this. We are fascinated by that word "profit". That profit, if you want to divide it by the number of those sharing in it, becomes a very small thing. It is pin money. When you divide it up, for instance, one share at \$100 would give you \$5, \$3, or whatever it is. It is a very small thing. It is only because you have a large number of shares that you get a certain amount of money; that is all. But in the very bottom of my heart I do believe that the patronage dividend is not worth being discussed. It is not worth it that we should be fascinated by that, because when you divide it up among all the members they do not get more than \$5 or \$6 or \$10 each, and it is not worth bothering about.

Q. You mean that while the system you propose might be unfair in principle, in practice it is of no consequence?

A. It is an accomplished fact.



Q. You say in practice it is not of much consequence?

A. No.

Q. Perhaps you are not familiar with the grain business, are you, Mr. Latour? A. No, sir.

Q. Or the milk business? If the patronage dividend could be large enough to amount to a cent a quart on milk -- ?

A. It cannot be done.

Q. You think it would not make any difference? A. It cannot be done.

THE CHAIRMAN: How much would you push the analogy to in connection with a bushel of wheat?

MR. FILLMORE: Seeing that it cannot be done on milk, I will just come to that.

Q. Supposing it meant five cents on a bushel of wheat. Would that not be an inducement? A. I will tell you. First of all, let us consider this. When you want to think of the patronage dividend, first of all think of the reserves that have been taxed. Think of what has been borrowed out of those patronage dividends, which has been taxed. Think of everything that has been taxed, and that patronage dividend has been cornered in a very small corner. So through that memorandum of ours we have brought that patronage dividend to a very small thing.

Q. You are really getting out of the dilemma by saying that in practice the patronage dividend is so small as to be of no consequence?

THE CHAIRMAN: What the witness says is that the reserve is the heart of the subject.

THE WITNESS: That is right.

BY MR. FILLMORE:

Q. Well, Mr. Latour, look at it from this point of view.





Supposing a co-operative makes a good profit. If it decides to pay that profit out to the members, and that is a deductible expense, the company pays no taxes? A. That is right.

Q. And if it keeps the great part of it as a reserve it might pay anywhere from 40 to 60 or 70 per cent to the government. Now, would not the inclination be to pay as much as possible out to the members? Would not the members at their meeting vote to take the patronage dividend, rather than leave it in the company where two-thirds might go for taxes? A. Well, let us say that would be the psychology and the tendency; but when you come to cold facts it is always this, that if you do not provide for reserves, your company or whatever the organization or corporation may be, is going to do what I cannot say in English, but what we call in French "allez chez le diable."

Q. Very well. Then take the case of a consumer co-operative. You say that a patronage dividend should be allowed as a deductible expense, likewise? A. Right. Will you narrow it down to a concrete case? You are speaking of a grocery business or a food business, or what?

Q. I mean by a consumer co-operative any co-operative where the members purchase goods, where they buy from the co-operative. A. I will tell you this, then, that you have to have an advantage to offer people to get them to buy in one place rather than in another place. In the food retail business the net profit is what; 3 per cent, 2 per cent or 5 per cent? Five per cent is very large. If you take that 5 per cent and spread it among all the customers, that is no money at all.

Q. Again you say the dividend is of no consequence? A. That is what I contend.



Q. And you say that the dividend is not large enough to be an inducing factor to enable the co-operative to get more business than the ordinary competitor? A. In the whole of Canada 75 per cent of all the grocery retail business, the proprietor or owner has never made more than \$1,200 a year net.

Q. I do not want to weary the Commission, but it seems to me, and you may correct me if I am wrong, that both in the case of the consumer co-operative and the producer co-operative you say that your recommendations, in practice, are not of any consequence; that you may as well allow patronage dividends, because in the long run it is a matter of small consequence? A. Provided the other enterprises be allowed to do the same.

Q. I thought you said it was a matter of small consequence in any event? A. But provided --

Q. All right. You do not recommend that a joint stock company should be allowed to pay dividends on share capital, and that those dividends should be a deductible expense, do you? A. No. Oh, well, I will tell you. That is a different question altogether, and in that brief it is stated, in the beginning, that we never discussed that question at all. That was a matter of doubt and argument and that is the story behind it; but we could never have that discussion about the co-operative movement at all. I think it is a very fine thing.

BY THE CHAIRMAN:

Q. Mr. Latour, in your recommendations which you make as to patronage dividends, have you studied the English system and the reports of the various commissions? A. We have studied that. I have looked into the texts, and we





have studied the references and everything, but still --

Q. You know, of course, that the patronage dividend over there is allowed as deductible? A. Yes, I know it is.

Q. Is it for the same reason which you give? A. I do not think it is. It is that the tax laws in England are different than in Canada. That is the main reason.

THE CHAIRMAN: That is what I wanted to make clear.

BY MR. ELLIOTT:

Q. I understood you to tell Mr. Brassard that a tax on income entered into the price of the article? A. Yes. A posteriori; after the fact.

Q. Did you also say that it tended to determine the price? A. I say it is in the price; it cannot be avoided.

Q. It comes out of the price? A. Yes, it may.

Q. But if it is raised suddenly; if the tax on income is increased suddenly, do you hold that that will increase the price of the product? A. It might lower it.

Q. That clears up the point I had in mind, then.

A. But it is a part of the price.

Q. It comes out of the proceeds. It must? A. I do not want to be misinterpreted. When I said it might lower the price I meant that it might be a good policy for the company to say, "We will not make any profit, because we do not want to pay any tax," so they would lower the price.

Q. You say, however, in that sentence which Mr. Brassard asked you about, on page 25, as I understand it, that any enterprise exempted from the present tax could lower its price? A. Yes, I said it could.

Q. Suppose it were making no profit now and paying no tax. Would you hold that a change in the rate of tax would affect its price policy? A. It might. A price policy



is something which is determined not only by the question of taxation. It is a very broad question; a question of computation, a question of markets, and so on.

Q. I understand there are a great many factors in it. A rise in the rate of income tax would not affect directly the position of a business that was making no income?

A. Of course not.

Q. So that -- A. A business that would not be making any income, that would not be a business at all.

Q. But there are businesses, or have been in past years, that made no income. A. That was accidental.

Q. Well, unintentional, certainly.

BY THE CHAIRMAN:

Q. Some have even operated at a loss, or so we have been told. A. Yes, I know. That is true.

BY MR. ELLIOTT:

Q. That was really the point of my question, that even with an increase in the tax, is it not possible that other circumstances would make the price of a product fall? A. It might be possible.

Q. Even though that meant a loss to the proprietor? A. It might be; but there are so many factors that it cannot be said that this special factor will have such an effect. All of the circumstances would have to be considered. I should like to add something to that, and it is this. A firm might very well decide not to pay any excess profits taxes, through a calculation which would result in fixing its prices much lower, in order to reduce its income. Then you would have the case of a tax rate bringing down the price.

Q. Especially if it were in the 100 per cent bracket?

A. Yes. But then again that is why we have asked that the



ordinary enterprise be put on the same level with the other, because they cannot do it now. That would be escaping the tax.

Q. Would your answer be the same with regard to the relationship of the tax <sup>to</sup> price if we were considering a sales tax, a tax on the value of the sales? A. That is different.

Q. Presumably that would be more readily passed on, which would more directly affect the price paid by the buyer? A. Well, it is all a question of whether it is a direct tax or an indirect tax. If it is a direct tax the consumer will have to pay it; the consumer will pay the tax and the price. In the case of an indirect tax we may not know about it; but in the case of the tax on cigarettes, for instance, we know that when we pay 33 cents for a package not much more than 6 or 7 cents goes to the company manufacturing those cigarettes.

Q. And how would you class the income tax? Would you call the income tax and excess profits tax a direct tax?

A. It is an indirect tax.

Q. The income tax? A. No, it is a direct tax.

Q. And an indirect tax is more readily passed on?

A. That is right.

PAR Me JEAN-MARIE NADEAU,

Commissaire.

Q. Monsieur Latour, nous avons eu un mémoire qui nous a été présenté par la Chambre canadienne de Commerce ...

R. Oui, nous en sommes membres...

Q. Dont les recommandations sont sensiblement différentes des votres. J'aimerais savoir si la Chambre canadienne de Commerce vous a soumis son propre mémoire pour étude et approbation? R. On a préparé nos mémoires ensemble, nous





avons travaillé ensemble pour la préparation de nos mémoires respectifs...

PAR Me ROGER BRASSARD:

Q. Non, pas la Chambre de Commerce de Montréal, mais la Chambre canadienne de Commerce? R. Non, non, je sais, la Canadian Chamber of Commerce.

PAR Me JEAN-MARIE NADEAU:

Commissaire.

Q. Connaissez-vous les conclusions auxquelles la Canadian Chamber of Commerce en est venue? R. Parfaitement, ils demandent de taxer la ristourne, c'est là que l'on ne s'entend pas, mais on s'entend par exemple sur tout le reste.

PAR M. le PRESIDENT:

Q. Les chemins se sont divisés à ce moment-là?

R. Juste sur ce point-là, maintenant, that could be a very long story, but it is not my story.

BY MR. FILLMORE:

Q. I would like to ask one question over again, if I may because I think the witness may have avoided answering to a certain extent. Under your proposal, Mr. Latour, your proposal being that patronage dividends should be a deductible expense both to a co-operative and to a joint stock company: now, assuming that a joint stock company has to pay a patronage dividend to meet competition, would not that deprive them of dividends and lower the value of their shares? A. I do not think it is of consequence. There is no relation between what you said and your conclusion.

Q. There is not? A. No, none at all.

Q. Well, that is a matter of opinion. A. That is my opinion.

Q. Well, that may be pretty tough on the shareholders of the joint stock company? A. I do not think so.



Q. If the dividends had to go to the patrons, to the customers, instead of going to the shareholders, is that not pretty tough on the shareholders? A. Why should they? There is no question about that at all. There is no consequence in what you are saying there.

Q. And if business is carried on in that way; if that proposal --

THE CHAIRMAN: It makes the life of the joint stock company just that much more onerous and painful.

THE WITNESS: What I mean is that the patronage dividend is not anything like the distributed profits to shareholders. It is not like them at all. It is a discount, and the joint stock company can always put in a discount if they want to. It is not always proof of the pudding that they will not always have a profit to distribute to shareholders. That is what I mean.

BY MR. FILLMORE:

Q. Your proposals, if adopted, might eventually result in loss of revenue to the Dominion Government? A. I do not think they would.

BY MR. ARNASON:

Q. I should like to ask you one or two questions, Mr. Latour. You may have dealt with them in replies to questions put to you by Mr. Brassard, and if so the Chairman will advise me. I understand your view to be that the patronage dividend of a co-operative should be distributed within a reasonable time? A. That is right, sir; in cash.

Q. So as to be considered an expense? A. Yes, sir.

Q. One question I should like to put to you is this. Supposing a person applies for membership in a co-operative, and that co-operative is organized with share capital?

A. Yes, sir.





Q. And suppose that person signs an application form, in which the applicant agrees to pay say 50 per cent of the par value of a share, and the terms of the contract are such that the applicant directs the co-operative to apply patronage dividends, which may be credited to the applicant, towards the payment of the balance of the share? A. Yes. That is all right.

Q. You think that would be all right? A. Yes; that is installment buying. It is all right. We do not want a tax there.

Q. One other point. A. You mean the capital stock of the company?

Q. Yes. That is fine. Then one further point. Did I understand you to say that if a patronage dividend were actually paid to the member there would be no objection to the member loaning that money back to the association, to be repayable within a definite period? A. Right.

Q. Did you have any particular procedure in mind there? There are different ways in which that can be done? A. Well, it is this; it is that we feel -- first of all, I must admit that there is a cleavage between the theory and the practice there. That is an admission. Anyway, that is life. I have lost track of your question, I am afraid. Would you repeat it for me?

Q. I understood you to say that there was no objection to the member loaning his patronage dividend back to the co-operative? A. Provided he had received it individually and returned it physically; it is all right. But I have seen it done in this way. A general meeting is called. Reports are read, and everything, and then there is a submission that the patronage dividend be fixed at such an amount, let



us say a percentage, and that perhaps 50 per cent of that will be paid in cash and the other 50 per cent will be considered as a loan to the co-operative, and the members will be given title to that loan, or scrip. There is no liberty there, because it is a general meeting, and the individual member does not consent. But in the case of the man who subscribes to the payment of his share, he does it individually, himself. There is a consent there.

BY THE CHAIRMAN:

Q. That is to say, once he gets his money it is harder to get it back from him than if you do it by deduction?

A. That is so. You know, we do collect dues in chambers of commerce.

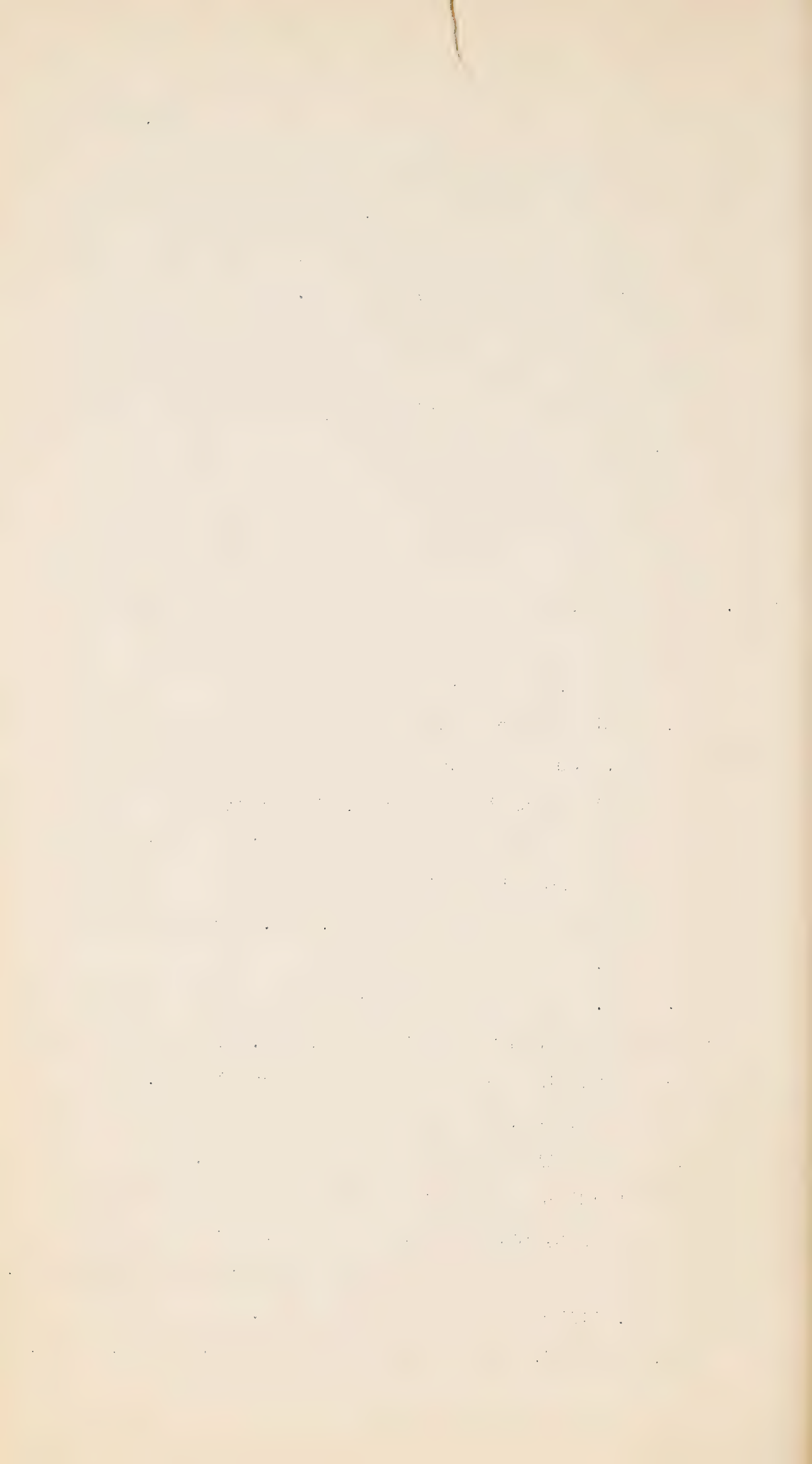
BY MR. ARNASON:

Q. Just one more question on that same point, if you will permit. Supposing the general meeting decides that 50 per cent is going to be repaid. Would that make any difference, if the member were given permission to withdraw that amount at any time by giving certain notice? Would that make any difference in your opinion? A. That would be a time deposit.

Q. Yes. Suppose he were given the right to withdraw it by giving say ninety days' notice? A. Yes; provided it has been given him first and he has turned it back. There is a great deal of difference there, because if you ask for it you may be called something you do not like.

THE CHAIRMAN: I think on behalf of the Commission we should thank you, Mr. Latour, for two things; for the clarity of your exposition and also for your bilingual accomplishments. I think Mr. Fillmore will agree with that.

MR. FILLMORE: I do, sir; and I wish to thank Mr. Latour.



But I crave your indulgence for just one question, because I may have given a wrong impression.

Q. Mr. Latour, if a farmer has grain to sell, we will say several thousand bushels, do you not think that even one-half cent a bushel would be an inducement to trade with A rather than with B? A. You cannot put that as a case, because he would not know in advance that he would be paid such an amount. He would know at the end of the year, or at the end of the period. I am speaking of a co-operative, of course. If it is a company called a co-operative, I do not know.

Q. I am speaking of a co-operative, which, by reason of the fact that it wishes to do business at cost, and pay no tax, is able to pay a cash price -- and I am talking about a cash price -- of one-half cent per bushel more than its competitor can pay. Would that not be an inducing factor? A. The only thing is that I doubt very much if the case is in effect in existence. If I saw that case it would be all right, but it is hard for me to admit it. If you tell me it is so, all right, but if you are only putting it as a case for discussion, that is different. If you say it is a real case, I say to you I am astonished.

Q. I do not want to make statements of fact. I would rather leave you in a state of astonishment. Are you engaged in trade and commerce, or are you the secretary of the association? A. I am the man living out of the dues paid by members.

MR. FILLMORE: I hope you get a good living.

THE CHAIRMAN: That is all you have, Mr. Brassard?

MR. BRASSARD: That is all, my Lord.

THE CHAIRMAN: Then we will adjourn now until 10 o'clock Monday morning.

--The Commission thereupon adjourned to meet on Monday, April 16, 1945, at 10 o'clock.





ROYAL COMMISSION  
ON  
CO-OPERATIVES

1945

PROCEEDINGS  
(OFFICIAL REPORT)

VOLUME No. XVIII

PLACE Ottawa

DATE April 16, 1945

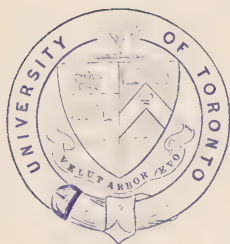
PAGES 5600 - 5727

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ROYAL COMMISSION ON CO-OPERATIVES

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Ottawa, Monday, April 16, 1945.

VOLUME XVIII  
(Pages 5600 - 5727)

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The Commission appointed to inquire into the present position of Co-operatives in the matter of income and excess profits tax, organization and business methods and operations, and the comparative position of persons engaged in business directly competitive therewith, met in Ottawa, Ontario, on Monday, April 16, 1945.

PRESENT:

The Hon. Mr. Justice ERROL M. McDOUGALL, Chairman.

B. H. ARNASON	}	Commissioners
G. A. ELLIOTT		
J. H. NADEAU		
J. J. VAUGHAN		

Eugene T. Parker, K.C.	}	Associate Counsel
Roger Brossard, K.C.		

Major H. D. Woods	}	Associate Registrars
J. A. Chapdelaine		

Colonel G. W. Ross	Executive Secretary
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APPEARANCES:

W. B. Francis	Group of Co-operative Associations
W. H. Howard, K.C.,	Private Grain Interests
W. P. Fillmore, K.C.	Private Grain Interests
R. H. Milliken, K.C.	Saskatchewan Co-operatives
G. W. Mason, K.C.	American Reciprocal Association
V. Evan Gray, K.C.	Factory Mutual Fire Insurance Companies
Hon. S. A. Hayden, K.C.	American Mutual Alliance
N. S. Robertson	Ontario Cash Mutuals
Russell MacKenzie, K.C.	Canadian Board of Marine Underwriters
J. A. Mann, K.C.	} Joint Stock Companies
Aime Geoffrion, K.C.	
A. Leslie Ham	



Ottawa, Ontario,  
Monday, April 16, 1945.

The Commission resumed at 10 a.m.

THE CHAIRMAN: Mr. Parker, I think it might be advisable to ask for the names of new appearances this morning.

MR. PARKER: Yes, Mr. Chairman.

THE CHAIRMAN: Will counsel kindly announce their appearances, so that the entry may be made in the Registrar's note ?

MR. G. W. MASON, K.C.: Mr. Chairman, I appear for the American Reciprocal Association.

MR. V. EVAN GRAY, K.C.: Mr. Chairman, I appear for the factory mutual fire insurance companies.

Hon. SALTER A. HAYDEN, K.C.: Mr. Chairman, I appear for the American Mutual Alliance.

MR. N. S. ROBERTSON: Mr. Chairman, I appear for the Ontario cash mutuals.

MR. RUSSELL MacKENZIE: Mr. Chairman, I appear for the Canadian Board of Marine Underwriters.

MR. J. A. MANN, K.C.: Mr. Chairman, I appear with my learned friends Mr. Aime Geoffrion, K.C. and Mr. A. Leslie Ham, for the joint stock companies.

THE CHAIRMAN: Mr. Parker, what is the order of business for the day ?

MR. PARKER: Mr. Chairman, I have availed myself of the opportunity of consulting with a number of counsel whose appearance has just been announced. In the insurance field for this week we have eight briefs, which must be dealt with and disposed of in some manner in a group of four mutuals -- the American reciprocals, the





factory mutuals, the American mutual lives and the Ontario cash mutuals. I think it would be agreeable to all concerned if we began with the reciprocals, to be followed by the factory mutuals, then by the American lives and, fourthly, by the Ontario cash mutuals. Then there are the Ontario farm mutuals, which are in a slightly different category from the four I have just named and are apparently not represented by counsel; and also there is the King's County mutual. Finally, there is the general brief on behalf of the non-mutuals, represented by Mr. Mann, Mr. Geoffrion and Mr. Ham. My suggestion would be that we take the four mutuals in the order I have named them, and that then Mr. Mann and his confreres might be heard as representing what are, in a sense, opposing interests. The farm mutuals and the King's County mutuals are perhaps of lesser importance and, as they would not take much time, could come in at the end. I believe that the order I have suggested will meet with the approval of all present.

THE CHAIRMAN: On many occasions we have discussed the question of whether or not the briefs should be read. As we all know, it is usually a very tedious performance.

MR. PARKER: I have suggested to some of the counsel that the briefs should not be read, but I am not sure there is any great unanimity about it. Perhaps we shall have to deal with the question as the various briefs come up, one at a time. I would suggest that if Mr. Mason desires to have his brief read, he should read it himself. Perhaps there are some paragraphs of it that need not be read and could be passed over with a comment, so as to save time. I understand that nearly all counsel present have seen the



brief, but if some have not I suppose it would be only proper to have the whole thing read, in order that they might be advised of its contents.

What do you say, Mr. Mason? Our difficulty is that if we read all the briefs we shall spend hours on the reading alone. I think everyone is familiar with the contents of the various briefs. However, we do not want to restrict you in any way.

MR. MASON: Mr. Chairman, the brief that I have is a very short one, and I think there is nothing in it that I could usefully leave out. As it is only about 10 per cent as long as most of them, I probably shall not offend very much by reading it.

THE CHAIRMAN: If we have your brief read, that must not be taken by other counsel as a precedent that will be followed. As yours is a very short brief, it may as well be read.

MR. MANN: Mr. Chairman, I take it that Mr. Mason has someone here to support the brief and answer questions, someone who will be subject to examination.

THE CHAIRMAN: That has been our practice. Have you anyone to support the facts as stated in the brief, Mr. Mason?

MR. MASON: Yes, Mr. Chairman, I have Mr. Gerrish, who will be able to answer any questions that may be asked as to the matters of fact set out in the brief. I apprehend it is not likely that many such questions will arise.

Mr. Chairman. In the brief I have not dealt with the history of the legislation relating to reciprocals in Canada, and it occurred to me that it might save time



and be useful to the Commission if I were to mention this history very shortly.

THE CHAIRMAN: Yes, I think so.

MR. MASON: Reciprocal insurance is not old in Canada. It originated in 1881, in the United States. I suppose, Mr. Chairman, it has already been brought to your attention that it originated with six dry goods merchants who were sitting at luncheon together one day in New York. The question came up as to the difficulty of getting adequate insurance of a proper type, and then and there after some discussion each of them agreed to insure the others to the extent of \$2,000; so each went away from the luncheon with \$10,000 additional insurance. That was the origin of reciprocal insurance, which I understand does not exist in England at all.

After a while other people were attracted to the new thing, and before long the original six men were unable to handle all the applications, so they appointed a committee. Eventually, as interest grew, it became desirable for each of them to appoint a competent attorney to look after the clerical work, the writing of policies and all that kind of thing on their behalf.

I am unable to tell the Commission exactly at what time the first policies were written in Canada, but the genesis of reciprocal insurance in Canada, as far as legislation is concerned, was in the year 1910. That followed a presentation that had been made by a distinguished member of the Bar of Quebec before a committee of the House of Commons. It is interesting to note that the points that were raised before that committee in 1909 and that led to legislation in 1910 gave a brief picture of this type of





insurance which remains true to-day. I am not going to take time to go into it at length, but shall merely indicate the salient points that were made, in order that the Commission may see that the same things still persist.

THE CHAIRMAN: What is the reference, Mr. Mason? Where can that be found?

MR. MASON: I do not know exactly, Mr. Chairman. It will be found in the records of the House of Commons, but where I do not know.

THE CHAIRMAN: Perhaps you can give us the date,

MR. MASON: The date is March 31, 1909, and the points were made before a committee of the House of Commons dealing with inter-insurance. I think that is as far as I should like to go with that, Mr. Chairman.

The first point which was then made and is still true is that there was no company, no stock, no association. I say there is no association, for while there is an association in a loose sense, there is no association in the legal sense. May I make the preliminary remark, Mr. Chairman, that in dealing with these matters one has to be very careful with the nomenclature. One gets in the habit of speaking of an exchange as if it were some association; I myself fall into that habit sometimes. As a matter of fact, an exchange is only a place at which the policies are exchanged. That is why it is called an exchange. A licence to an association of this kind--it is not an association legally--ought to be to the subscribers at such and such an exchange. They are the people who really constitute the exchange.

That is the first point, that there is no company, no stock, no association. It is different from the mutual



system, because if anyone is unable to pay his liability others are not called upon. It is a several liability, not a joint liability in any sense. Then there are the constant inspections and requirements, resulting in low rates. And it was said at that time that the public do not take risks in such groups, which is still true to-day, because the persons in these groups are usually of a select type. Persons of a like business usually associate in a certain group.

THE CHAIRMAN: Is this form of insurance associated with any particular kind of business?

MR. MASON: No, Mr. Chairman, but it lends itself principally to the larger types of business. As a matter of fact--Mr. Gerrish could confirm this, if desired--the people who are principally concerned in this type of insurance are the larger commercial organizations, which find certain benefits in it which it is worth their while to have.

It was pointed out in 1909 that there was a tendency towards monopoly in insurance if insurance of this kind were not permitted. This is also true to-day.

As a result of what was done in 1909 Parliament made in the following year an enactment which is section 139 of Chapter 32 of the Statutes 9-10 Edward VII. In reading this section I will eliminate portions which refer to other groups as well. The section says:

"Notwithstanding anything in this Act contained, any person may insure his property, or any property in which he has an insurable interest, situated in Canada . . . and may also insure with persons who reciprocally insure for protection only and not for profit . . ."



Mr. Chairman, you will observe the language of this first legislation passed by Parliament on the subject-- "reciprocally insure for protection only and not for profit". Then it goes on to say that any property insured or to be insured may be inspected and any loss incurred may be adjusted.

The section has this proviso, which was dispensed with subsequently:

"Provided such insurance is effected outside of Canada and without any solicitation whatsoever directly or indirectly. . . and provided further that no such company, underwriters or persons shall within Canada advertise their business. . ."

As this type of insurance became more popular, the provinces passed legislation with respect to it. I shall not take time to go over the whole history, but shall merely indicate the general nature of it. One question that arose was whether a commercial company would, under its charter, have the power to enter into a transaction of this kind with other companies or individuals. There was a great volume of authority in the United States to indicate that a company had that as an incidental power, but the matter had not come up in Canada. Therefore legislation was introduced in Ontario to provide that a company had the right to arrange such insurance with other companies or individuals.

Another question that arose was as to whether a company that entered into an arrangement of this kind became an insurance society. Again there was ample authority in the United States, indicating that a person who entered into a transaction of this kind was not





carrying on the business of insurance. It is true such a person was insuring other individuals by a private arrangement or contract, but he was not entering into the business of insurance, and to make assurance doubly sure that was so provided in Ontario legislation.

Matters went along in that way until 1922, when the Province of Ontario passed legislation providing for the licensing of these exchanges. Objection was taken to that and litigation arose, the question finally going to the Judicial Committee of the Privy Council.

You will recall, Mr. Chairman, the insurance reference of 1916, when it was held that certain provisions of the Dominion Insurance Act of 1910 were ultra vires. That is the Act to which I have already referred. Then in 1917, I think it was, amendments were made to the Criminal Code of Canada which it was apparently hoped would have the same effect as the provisions of the Insurance Act that had been found to be ultra vires, the idea being that these amendments could be supported on the ground that they were in the Criminal Code. But in the insurance reference of 1924 it was held by the Privy Council that what could not be done directly could not be done indirectly, that the provinces had jurisdiction over reciprocal insurance, and that these amendments in the Criminal Code were ultra vires of the Dominion. The reference is Attorney-General for Ontario v. Attorney-General for Canada, (1924) Appeal Cases, page 328. The former Chief Justice of Canada, Sir Lyman Duff, sat as a member of the Committee in that case, and I should like to read a brief portion from his judgment. At the beginning of the second paragraph on page 343 he refers to the Ontario Act, and he goes on:



"This Act, as its name imports, is a statute dealing with reciprocal contracts of insurance. The practice of forming groups, for the purpose of exchanging such contracts of insurance, appears to have originated in the United States and to prevail widely there and in Canada. Such groups, described as exchanges in the Act, are usually composed of persons having some common interest, as owners of a particular class of property, for example, or dealers in the same kinds of commodities. The contracts are effected, and the business incidental to them transacted, through the agency of an attorney, who is empowered by each subscriber individually to act for him in making such contracts with other members of the exchange. The exchange, as a whole, undertakes no obligation, the attorney, who receives a commission for his services, in every case acting for the subscriber as an individual, and the obligation of the subscriber being his own individual obligation."

That sets out in very terse language, as one would expect, the nature of reciprocal insurance.

Before I leave the cases I want to refer the Commission to Re Insurance Contracts 58 Ontario Law Reports, page 404. That was a reference in 1926 to the Appellate Division of the Supreme Court of Ontario by the Lieutenant-Governor, under the provisions of the Constitutional Questions Act. Among those who appeared was the late Mr. Wegenast, for Reciprocal Insurers, and a submission was made (page 406) that they were not in the insurance business, that they merely made contracts with one another. The Court said it would not hear Reciprocal Insurers, because it did not



regard them as being within the scope of the reference inasmuch as they were not in the insurance business but only made contracts with one another. There was no definite dealing with that point in the reasons for judgment.

THE CHAIRMAN: Are you leading up to an argument that your clients are not within the terms of this reference?

MR. MASON: No, Mr. Chairman. I have raised that point, but we are not much concerned with it. We are here now, and I should like to deal with the point. I am thinking at the moment of certain allegations made as to the business of insurance in one of the briefs, and I wish to lay a foundation for the argument, if it becomes necessary, that my clients are not in the insurance business as such, that their business is merely the individual exchanging of contracts.

Mr. Chairman, I wish to point out to the Commission that unfortunately I did not receive a copy of the supplementary brief filed by the joint stock companies until Saturday, so I have not had an opportunity to give it as much attention as I should like. I noticed that it contains a reference to the report of the Insurance Commission appointed by the Legislative Assembly of Ontario in 1919. I suppose a copy of that report has already been filed with the Commission. The late Mr. Justice Masten, the Commissioner, said, at page 34:

"I was attended by certain insurers in this province who have in the past been accustomed to insure outside the province in a form of insurance known as reciprocal or inter-insurance. Many features of this





class of insurance are similar to that practised by the New England Mutuals, the principal difference being that in the case of the New England Mutuals the insurance is effected by an incorporated mutual company, and the claim of the insured in case of a loss is met by the corporation. In the case of the reciprocals there is no company; the whole liability rests on contract. Each of the reciprocal insurers covenants and agrees with every other to become liable in the event of loss for a certain sum, and the remedy in case of such loss is against each of the co-insurers, under the terms of the written contract which he has signed."

Stopping there for a moment, Mr. Chairman, may I point out that appended to the brief which has been filed is a form of subscriber's agreement at associated reciprocal exchanges. Now, anything that is not in there cannot be done. This is the complete code. In order to determine what the real nature of reciprocal insurance is, all that one has to do is to look over this. That is a short and easy means of arriving at the true nature of reciprocal insurance. The true nature of it is, not what somebody says it is, but what is contained in the terms of the contract itself. Everybody who enters into an arrangement at an exchange must sign that agreement. If he does not sign that agreement he gets no interest in it, he cannot have any interest in it. So this is not a matter in which an exchange is dealing with the public at large, Mr. Chairman; the exchange is dealing only with its own subscribers.

Mr. Justice Masten goes on:

"The principal insurers in Ontario who have adopted this method of doing business are



lumbermen and certain large mercantile firms, and the evidence before me strongly indicated it was in the public interest that insurers should be able to protect themselves in this manner. The view which I have already expressed in respect to unlicensed insurance applies to this, viz., that nothing ought to be done which would preclude competition by these organizations.

In addition, a draft bill was presented to me which was said to have been passed and to be in force in twenty-eight of the United States of America, and I have been asked to express my approval of that bill.

Owing to the nature of the contract of reciprocal or inter-insurance, I am of the opinion that it is something which comes within the jurisdiction of the province of Ontario, rather than within the jurisdiction of the Dominion, as being a matter of property and civil rights within the province. Owing to the fact that there is no insuring company, and to other considerations which readily appear from the nature of the business itself, it is not readily possible--in fact, it is claimed to be impossible--for these organizations to make such a deposit with the Insurance Department as is called for by the Insurance Act."

Notwithstanding that, that was subsequently done.

His Lordship continues:

"The necessity for a deposit being made with the Insurance Department arises from the necessity of making certain that insurers shall receive the



amount of their loss in case of fire, and that there be a fund available in the hands of the Government for this purpose in case they fail to do so.

Having regard to the financial standing of the class of insurers who make use of this reciprocal or inter-insurance, it appears to me that it may be possible, after careful scrutiny by the Superintendent, to relieve them on proper terms from the necessity of making the deposit called for by the Insurance Act, and that the legislation which they seek to have enacted is worthy of sympathetic and thorough consideration."

Then he goes on to say that it has been approved in twenty-eight states.

THE CHAIRMAN: Can you make that report available to us, Mr. Mason? I see it has been cited in one of the opposing briefs. We have not got that on file.

MR. MASON: It is a borrowed copy that I am using, Mr. Chairman.

MR. ROBERTSON: I have a copy here, Mr. Chairman, which the Commission may have.





MR. MASON: That brings me to the brief, but I should like to make this observation. Not having had the privilege of being here very often --

THE CHAIRMAN: I do not know whether that is a privilege or not.

MR. MASON: --I do not know precisely what material has been filed with the Commission. Has there been filed here a copy of the agreement between the Dominion and the provinces with regard to taxation, under which it was agreed that the provinces should forego certain taxes during the war, and for some short period thereafter, and that in the interval the Dominion alone should impose certain taxes?

THE CHAIRMAN: That has not been produced, but it is very easily obtainable.

MR. MANN: Is that not in the statutes? I know the Quebec agreement is in the Quebec statutes of 1942. I think it is a separate agreement with respect to the provinces, because Quebec has a separate agreement. They must be all separate agreements, because there are different amounts of subsidies.

MR. MASON: The reason I draw attention to it at the moment is this. Certain types of taxes during this period are not imposed by the provinces. So far as this type of insurance is concerned, and other types that will be dealt with before the board, there is or was provincial taxation; so that you had provincial taxation, you had the Dominion taxation, and then as a consequence of this agreement the provinces ceased for the time being to impose the taxation and the Dominion imposed it.

THE CHAIRMAN: That has been referred to on many



occasions.

MR. MASON: And you will recall that in 1942 there were amendments to the statute dealing with that matter. What I wanted to point out is that in dealing with this matter of taxation it is rather important that one should bear in mind that at some time, we hope in the not very distant future, those agreements will be at an end, and that then we are going to have two taxing jurisdictions operating again. These considerations ought to be of very considerable moment in trying to devise any suggestions to the government as to just what sort of taxation should be imposed. Indeed, it seems a very inappropriate time to ask for any change with respect to these matters, when the whole situation may be changed very shortly by reason of these agreements coming to an end.

I am particularly interested in that because, as I have said in the brief, the subscribers to these exchanges, or at these exchanges, are substantially all commercial operations who are now paying income tax and excess profits tax, and who are exposed to all the hazards that double taxation means. I do not suppose it has been before your Commission so much as it has before another commission which has just finished its labours, but we are all aware that with the heavy income tax that is being imposed companies are not able to accumulate surpluses of a liquid character. When the impact of double succession duties comes, it means that in the case where you may have half a million dollars worth of real estate owned by a family or an individual, or where an individual may have \$1,000,000 of capital locked up in a factory, which represents the plowed-in profits of years, there is virtual extermination of those companies.

I am merely mentioning that. I am not asking your



Commission to pass upon it, but that is the position in which my real clients, the subscribers on these exchanges, find themselves to-day; and I do ask the Commission to bear in mind in making any representations or findings that this whole situation as to taxation is in a perilous position indeed and that particularly having regard to this agreement one should go slowly before making any change.

That brings me to my brief. I will precede the reading of the brief by saying that of these various exchanges mentioned on the first page, the Underwriters Exchange, the second one on the list, does practically nothing in Canada. Really the ones that operate in Canada are the Lumbermen's Underwriting Alliance; then, going down a little further, the Individual Underwriters, and the next several following that, down to the Canadian Reciprocal Underwriters; then, omitting the next two, the Cannors and Warner Reciprocal. That means there are ten of this group that have substantial operation in Canada. The rest of them, with the exception of Underwriters Exchange, which has a negligible amount of business here, do not operate in Canada at all; but they are set out here because they are members of this Reciprocal Association.

Brief submitted by The American  
Reciprocal Insurance Association

MR. MASON: "1. This association includes in its membership the following exchanges:

Consolidated Underwriters,  
Underwriters Exchange,  
Lumbermen's Underwriting Alliance,  
Universal Underwriters,  
Reciprocal Exchange,





Casualty Reciprocal Exchange,  
Individual Underwriters,  
New York Reciprocal Underwriters,  
Affiliated Underwriters,  
Fireproof-Sprinklered Underwriters,  
Metropolitan Inter-Insurers,  
American Exchange Underwriters,  
Canadian Reciprocal Underwriters,  
Druggists Indemnity Exchange,  
Casualty Indemnity Exchange,  
Canners Exchange Subscribers at Warner  
Inter-Insurance Bureau,  
Warner Reciprocal Insurers,  
California Casualty Indemnity Exchange,  
Industrial Indemnity Exchange,  
Manufacturers & Wholesalers Indemnity Exchange,

and submits this brief without prejudice to its position that its members are not within the language of Order in Council P.C. 8725.

"2. Reciprocal fire insurance originated in 1881 with the establishment of Individual Underwriters."

That is one of the group mentioned previously.

"A number of prominent drygoods merchants conceived the idea of insuring one another. The first reciprocal underwriting in Canada was in 1889. These exchanges have no corporate entity and do not exist for profit but are controlled by the members, commonly called subscribers, and operate exclusively for their benefit. There are no shareholders or third persons interested in deriving a profit from the operation of the exchanges. Their purpose is to provide a high degree of security to the subscribers at the



minimum of cost.

"3. As reciprocal insurance developed it became convenient to have a common agent or attorney who would transact the business of the exchange. Each subscriber gives a power of attorney to the common attorney to transact the necessary business on his behalf. The attorney collects moneys from each subscriber which are placed to the credit of the subscriber and remain the property of the subscriber."

Will you please note that, because if I fail to mention it later I want to say now that each subscriber has an individual account.

"The attorney deducts from this amount such sum as may be required to pay losses and expenses and provide necessary reserves and surplus, the part not needed is returned to the subscribers annually and in the event of withdrawal from the exchange the subscriber receives from the attorney all the money at his credit, including his share of any reserves and surplus.

"4. Nearly all of the subscribers are corporate bodies but in the case of all subscribers the moneys paid to them by the attorney each year are subject to income tax and excess profits tax so that a further imposition of such taxes on the moneys of the subscribers in the possession of the attorney would mean double taxation.

"5. Theoretically the amount deposited by a subscriber need be only sufficient to take care of his portion of the cost of operating the exchange, in which event there would be no money available for taxation in the hands of the attorney, but in practice it is found desirable to have the amount deposited by the subscriber sufficient to cover



contingencies, including the possibility of unexpectedly high losses. Were it not for the number of subscribers involved and their being widely scattered it would not be necessary for the subscriber to pay anything until the end of the year's experience at which time he would make his proportionate contribution. There would, therefore, be nothing to tax."

I am informed that in the United States there are mutuals which they call county mutuals. I do not think we have anything like them here, but they actually operate on that basis. They wait until the end of the year, and then they contribute whatever is necessary to pay the losses of the year, and they never pay anything beyond the losses and, of course, the expenses incidental thereto.

"6. The office operated by the subscribers through the attorney for the purpose of the exchange of contracts by the subscribers is commonly known as the exchange and for that reason the assemblage of the subscribers in a particular group is commonly known as an exchange with some additional name to identify the particular group.

"7. The exchange is neither a corporation nor an association. It is merely the place at which the exchange of contracts takes place. It is apparent, therefore, that an exchange has no income. In reality the subscriber pays no premium."

Will you again permit me to say that in this brief, and I have no doubt in anything I may say, I may use the word "premium" because that again is a common word. But that really is an error in nomenclature which one falls into by reason of it conveying something to one's mind in ordinary practice. In the case of an exchange it is more accurately





called a deposit.

THE CHAIRMAN: You might call it a consideration, might you not?

MR. MASON: I would submit not, because a consideration would imply that the whole thing would be in consideration of somebody else's contract. That is not so; because under our system we only become liable for that portion which is shown by the losses and expenses to exist. Even with what my learned friends have referred to as investment income, we are required to keep up certain deposits, by law; and the amount of securities filed bears certain income. When that income is received by us it goes to the credit, or at least a proportionate share goes to the credit, of each individual subscriber, and if he were to leave the exchange the next day, he would take that. That is his; it never becomes the property of the exchange.

THE CHAIRMAN: Your assured gets the advantage. He gets his insurance, does he not? There must be a consideration for that.

MR. MASON: Certainly there is.

THE CHAIRMAN: What is the consideration?

MR. MASON: The consideration for the insurance is the covenanting of each to pay. That is, in case of a loss, the others are covenanted to contribute that loss, subject to the limitations in the document.

"He makes a deposit out of which his proportionate share of losses and expenses is paid. The portion of the deposit that is returned to him is not really a dividend because it is merely the unused part of a fund previously advanced by the subscriber and remaining to his individual credit. Even where the laws of various jurisdictions require a surplus



fund as a provision against unusual losses the funds remain the absolute property of the subscriber and any taxation of these funds, whether on investment income or underwriting income, is really a tax on individual subscribers who already pay income tax on their incomes."

I have used an expression there that is used by the office of the Superintendent of Insurance, but which I submit is not correct as applied to these exchanges. There is no underwriting income, for the reasons previously set out. When we make our returns we have to use the same form of return that is prepared for joint stock companies, which use the term "underwriting profit", but in my submission that is purely a misnomer.

MR. NADEAU: I see on page 3, to which you just referred, the statement that an exchange has no income. In your subscriber's agreement, paragraph 29(a), you refer to the fact that an exchange might have a current income. Would you tell me how those statements can be reconciled?

MR. MASON: What is called there the current income goes into the individual account of each subscriber. It is not income that is held by anybody other than for the subscribers. The attorney, or in some cases it is the advisory committee, gets that, and it is credited to each of the individual accounts.

"8. The only profit or income realized in connection with an exchange is that made by the attorney who, whether an individual or a corporation, is subject to income tax and excess profits taxes.

"9. If a man insures his business in a stock insurance company the premium he pays is deducted from the income of



his business as a business expense. If he is a subscriber in an exchange the moneys paid by him and not needed are returned to him and taxed to him as additional income, or the amount of his deduction as a business expense is reduced by that amount and his taxation is, therefore, increased. If the funds held by the exchange are taxed the savings to the subscriber are reduced by that amount and the government will receive a correspondingly less sum from the subscriber."

Just to put that in another way, when a man becomes a subscriber to an exchange and pays in a certain sum of money, naturally he pays that out of earnings which have already been subject to taxation. Then when in any particular year, later on a certain sum has been accumulated, he gets an amount and then, of course, the amount that is available for tax, in his hands, is increased by that amount. So the situation that exists with regard to these exchanges in Canada is that all these moneys that are called savings or unused deposits, or however they may be described, are already paying taxes on account of the particular character of these subscribers. They are already paying excess profits tax and income tax.

THE CHAIRMAN: Would the amount being paid by the reciprocal be the same as the amount paid by its members, if they were reporting separately? I hardly think so.

MR. MASON: I do not know that I quite understand, but I will break up the question, if I may. There is a certain amount which is paid into the exchange and which goes for expenses and losses. Then the rest, including the interest on investments, goes back into the hands of the subscriber.

THE CHAIRMAN: And there is taxed?

MR. MASON: Yes.

THE CHAIRMAN: Had it been taxed in the hands of the





agent or the reciprocal, let us call it that, would the yield have been the same to the government?

MR. MASON: If they made provision for losses and expenses, as I suppose they would, I presume it would be the same thing. The only point is this, in that event. If they did it before and did it after, it would be the very same moneys that would be taxed. I hope I make myself clear. It is suggested, for instance, in the briefs of my learned friends that there is a double taxation also in the case of joint stock companies, because a joint stock company is taxed --

THE CHAIRMAN: Oh, we certainly enjoy double taxation.

MR. MASON: But there is this difference. The profits of a joint stock company are taxed, and then there is a dividend to the shareholders. Then later there is taxation according to the particular financial position of the dividendee. That is not on the same moneys. I mean to say, the income of the company is not the income of the shareholders. It is a different case. But in this case, in the case of an exchange, there is this very important difference; that no matter how the government were to tax it, it is the money of the subscriber.

THE CHAIRMAN: Would you say the same for the investment income?

MR. MASON: Oh, absolutely. I say that for this reason, that the investment income, as soon as it comes in -- I do not mean it is done every week, but periodically -- that is divided among all the subscribers according to their shares and credited to their actual accounts.

MR. ELLIOTT: Are the properties insured entirely businesses owned by corporations?

MR. MASON: No, I cannot say that; I think some would be



owned by firms.

MR. ELLIOTT: They are all business properties?

MR. MASON: Yes, all business properties. I do not want to be misunderstood in that. It may be that in some jurisdictions, perhaps in some of the states, reciprocals may deal in certain classes of property, smaller classes, and so on; but there is nothing of the kind that I know of in Canada. For instance, there is one reciprocal called the Cannerymen. They would be all cannerymen in that. Another would be wholesale merchants, and properties of that type. I think I am safe in saying that substantially all of them, if not all, are commercial concerns already subject to taxation.

THE CHAIRMAN: As a matter of interest, in what fields do the reciprocals operate chiefly; what type of industrials?

MR. MASON: Large commercial concerns of various types.

THE CHAIRMAN: Confined to any particular branch?

MR. MASON: No. But there is a tendency for them to segregate.

THE CHAIRMAN: That is what I mean; what is the segregation?

MR. MASON: In one case it is cannerymen. In another case it may be wholesale merchants. In another case it may be departmental stores, and buildings. That would not be exclusively so, of course. The reason they do that, of course, is this; and I am glad you asked me that question. They have common problems then which they try to meet. As a matter of fact one of the reasons why these people go into it is not for the matter of the saving that results, although most people are looking for savings in these times if they can get them, but that is not the main consideration. The main consideration is that there is a picked selection. A man or a



concern cannot get into one of these exchanges unless he is exposed to a searching investigation as to the commercial record, as to the condition of the premises, as to the financial responsibility; and committees have to pass upon these things. If a concern does not measure up, it does not get in; because their object is to eliminate fire hazards. They have gone a tremendous way toward the elimination of fire hazards. These and other allied concerns were among the pioneers in arranging for the sprinklered risks, and one can readily see what a tremendous contribution that has been to savings in the insurance business.

MR. ARNASON: The membership in these exchanges includes partnerships?

MR. MASON: Yes, except that the number of persons conducting business as partnerships now, having regard to the number conducting them as incorporated companies, is comparatively small. There would be nothing to prevent an individual from coming in, if he could qualify; but if there are any individuals I know of none. However, it might be that a man might own a large concern in his own name, and still qualify.

THE CHAIRMAN: Have the reciprocals in the United States been assimilated corporations, largely?

MR. MASON: From my knowledge I would say undoubtedly no, because in 1942 this whole matter was the subject of an exhaustive inquiry before the United States Senate and House of Representatives, sitting separately; and they recognized -- I think I point that out in this brief -- the peculiar nature of the reciprocal exchanges.

THE CHAIRMAN: It is not a matter of a partnership, or of a corporation, or of an association?

MR. MASON: No, it is not one of those. In a loose form





it is sometimes called an association. I think I have called it an association myself, but that is only in a loose form. That is the distinguishing mark.

"10. The fundamental idea of reciprocal insurance is to obtain protection at cost. It does not require for its operation the maintenance of a system of local agents."

This is one reason why we are attacked, I am afraid. We do not have to go out and sell insurance. It is true, I suppose, that there is some solicitation now, because that old bar is not still operative, but it pretty well sells itself on account of the valuable nature of its protection.

THE CHAIRMAN: That must be a great advantage.

MR. MASON: Oh, yes; but I can easily understand why associations of agents would object to it, because they say, "We make our living out of this sort of thing," and so on. "It has a highly proficient inspection of risks. The operation is much cheaper than that of a stock insurance company which must pay commissions on premiums to its agents.

"11. It has become the practice of the attorneys to retain a portion of the subscriber's deposit by way of reserve to the individual credit of the subscriber until the amount represents a substantial surplus fund. This is always available for the payment of losses and when the subscriber retires he is entitled to the full amount standing to his credit, less his proper share of losses and expenses incurred to the date of retirement. The investment income from the funds is the sole property of the subscribers and is apportioned to their respective accounts.

"12. Each exchange has an advisory committee composed of representatives of the subscribers. This committee has the ultimate control of the affairs of the exchange, passes



upon the acceptability of the applicants for insurance and acts as trustee for all funds. The members of the committee are elected at the annual meeting of subscribers. An agreement is entered into by each subscriber giving the attorney the necessary powers to act on behalf of the subscribers. A copy of the agreement used by Associated Reciprocal Exchanges -- "

That is a group of six or seven of them.

"-- is hereto attached. Attention is drawn particularly to paragraphs 44 to 52 inclusive."

I will not take time to read those paragraphs unless you desire me to do so, but in view of what has been said about a partnership, for instance, may I look at Section 47, which says:

"No subscriber shall be or become liable for any default, failure or neglect on the part of any other subscriber."

That is immediately at odds with the fundamental idea of partnership, as to responsibility for profits and losses. This is purely an individual liability. Without taking time, because I know how precious time is, and I think I have taken considerable already, I do want to say that whenever any statement is made that may challenge the accuracy of what I have said, one does not need to go any place else than to this document. That is one of the reasons I thought perhaps it would not be necessary to ask my friend Mr. Gerrish very many questions, because the answers to everything are there.

"13. It is said on behalf of certain stock companies that there is a disparity in treatment between them and reciprocal exchanges. If one considers only the amount of taxes paid by a stock company as compared with the amount paid by an exchange there is a disparity on the surface but when organization and method are analysed there is in fact no





disparity because there are no profits to stockholders on that portion of his income which the exchange has paid to him, or is taxable in respect thereof. The proposals to subject the exchanges to income and excess profits taxes, if carried out, would not remove disparity. They would create disparity because they would impose a double taxation that does not now exist.

"14. The amount of the premiums (so-called) of all exchanges in Canada according to the report of the Superintendent of Insurance for Canada for the year ending December 31, 1940, was \$762,728 out of a total of \$84,168,663 or about 9/10ths of one per centum of the total, but the economic value of the competition afforded by exchanges and also by mutuals is of great importance because the giving of service to subscribers at a low cost tends to lessen the amount of premiums charged by the stock companies which for a number of years past have been such as to enable the companies to earn large profits."

Proof of that will be found in the schedules attached to the supplementary brief filed by the joint stock companies. "It is of the greatest importance to all insurers that there should be sufficient competition to keep rates within reasonable bounds."

Stopping there a moment, speaking subject to correction, I think the total proportion of all the insurance carried by reciprocal exchanges and by mutuals in Canada is something less than 10 per cent; probably  $8\frac{1}{2}$  per cent. The great bulk, therefore, or something like 90 per cent or more, is carried by the joint stock companies, so we cannot say that the operation of these exchanges has been such as to cripple the amount of insurance that the competitors are getting. But one can readily observe that the providing of this competition is





a speedy check upon the charging of high premiums by joint stock companies.

THE CHAIRMAN: When you say those companies earn large profits, I assume that applies to all insurance enterprises at this time?

MR. MASON: No, I am referring to the joint stock companies.

THE CHAIRMAN: Do you single them out as the only ones who have made large profits in the last few years?

MR. MASON: Oh, no, Mr. Chairman; I am speaking purely of insurance companies.

"In recent years the amount of taxes paid by individual companies with share capital has been high because the profits have been unusually high. If the premiums charged by these companies approximated more closely the aggregate of their losses and expenses and reserve requirements without leaving an excessive amount for profits their taxes would have been correspondingly small."

What I say there is that if their premiums are lower, their profits are less.

"The division of the fire insurance business between the stock companies and other types of insurers in Canada clearly shows that the stock companies have not been suffering unduly from competition. In the report of the Superintendent of Insurance for Canada for the year ending 1942 at pages XCV to XCVII inclusive, it will be found by making the necessary additions that the stock companies do 87.5 per cent of the whole business.

"15. There has been pressure from some leaders in the insurance business to reduce the rates charged by the stock companies. One of these gentlemen, Mr. W. E. Baldwin,



President of 'All Canada Insurance Federation' comprising about 200 companies transacting fire and casualty insurance business throughout Canada, was the author of several articles published in the New York Journal of Commerce. In an article published in December 1939 he said:

'In Ontario and Quebec, however, notwithstanding the fact that much time has been spent in attempting to present a revision of rates which would reflect the excellent experience on a number of classes, no action has been taken on the program suggested. On one pretext or another every effort to bring about a change that would allow the public to benefit from the promulgation of lower rates, and at the same time permit the associated companies to meet non-tariff competition has been effectively blocked.'

"In an article published in December, 1940, he said:

'It is reasonable to anticipate that the end of 1940 will terminate an era of seven years in Canada during which the loss ratio has only twice been above 40 per cent and the average for the period is 37.78 per cent predicted on our estimates for 1940 being approximately correct.'

"In an article published in December, 1941, he said:

'While some headway has been made by the territorial boards in Canada toward substantial rate reductions, the Canadian Underwriters Association has maintained its record of masterly inactivity in so far as Ontario is concerned. Outside of the reduction brought about by the writing of mercantile policies for three years, no general rate reductions have been made and many rates are entirely too high, as the continuing favourable loss ratio clearly indicates.'

"While the loss ratio has increased in 1942 and 1943 owing apparently to conditions flowing from the war, Mr. Baldwin



was speaking of a situation existing as recently as the year 1941.

"The very favourable loss experience and the high earnings of stock companies in Canada show how immune the premium rate regulating procedure of those companies is to considerations of interest to the policy holders. An insurance organization with share capital can be taxed on the profit or gain enjoyed by the shareholders without reaching the policy holder while, on the other hand, there is no way in which a purely mutual insurance organization or exchange can be taxed without increasing the cost of insurance to the members.

"16. The distinguishing features of reciprocal insurance previously mentioned have been recognized in judicial decisions. The leading case on reciprocal insurance in the United States is *Wysong vs. Automobile Underwriters*, 204 Ind. 493, 184 N.E. Rep. 783.

"It held that - 'Reciprocal or inter-insurance is not a statutory entity but only regulated by law' and that 'It is by private contract that the relations created among and between the subscribers are fixed and determined.'

"In the case of *In re Manufacturing Lumbermen's Underwriters*, 18 Fed. Supp. page 114, the court held that - 'Manufacturing Lumbermen's Underwriters is not an entity', that 'the sole constitution of this association is the power of attorney given by each subscriber to the attorney-in-fact,' and that 'We have found nothing in the constitution of the association --'

--that is, using it in the same sense that we discussed previously --

"'--pursuant to which the association as an entity separate from its subscribers and from the attorney-in-fact for each





subscriber, can become indebted.' The last mentioned quotation makes it clear that while the word 'association' is used the court does not regard the exchange as an association in fact.

"There appears to be no form of underwriting in Great Britain answering to the description of a reciprocal exchange. While in some respects the practice of the reciprocal exchanges is similar to that of some mutuals, reciprocal insurance differs from mutual insurance. In the reciprocal there is no company and no integral organization. The liability of subscribers is not joint but several. Each subscriber secures insurance in severalty from the other subscribers and is in turn liable in severalty to each subscriber. This method of underwriting is 'peculiarly calculated to bring together risks of a similar character and hazard and this promotes a degree of emulation and specialization in fire prevention which is not attainable under any other system.

"17. In 1942 representations were made to the Congress of the United States of America asking that mutual insurance companies and reciprocal exchanges should be subject to income tax. There were lengthy hearings before committees of the Senate and the House of Representatives in the course of which the nature of reciprocal insurance was very fully discussed and eventually the treasury department of the United States took the position that there was nothing to tax against reciprocal exchanges except interest earnings. They agreed that the deposits paid by the subscribers should not be taxed. They agreed with the view that it is the subscribers who act and not the exchange, the exchange being a mere place and not an entity; that the subscriber does not pay a premium for insurance or contribute to any joint fund but, on the contrary,



pays a deposit which remains his individual property out of which the attorney, not the exchange, pays his proportionate part of the losses and of certain expenses, and that the unused portion is returned to the subscriber not as a dividend but as a refund. It was also made clear to the treasury department that when the deposits are returned to subscribers such returns are moneys of the subscriber liable to income and excess profits taxes.

"It was further pointed out to the committees hearing the representations for and against the proposed taxation that an exchange should not be taxed for interest earnings because they do not belong to the exchange but to the respective subscribers and are credited to the separate accounts of the subscribers.

"In the result Congress gave each exchange an exemption as to net interest earnings up to \$50,000 and imposed no other taxation of any kind on the exchanges. The legislation passed is found in the Revenue Act of 1942, U.S. Code Annotated Title 26, page 188 et seq., particularly beginning with paragraph 207. 'Net income' is defined therein as gross investment income less:

- (a) tax free interest,
- (b) investment expense,
- (c) real estate expenses,
- (d) taxation,
- (e) interest paid or accrued,
- (f) capital losses.

After all of these deductions there is a further exemption up to \$50,000."

So the position there is that the only thing they tax in the United States is the investment income, after having



given --

THE CHAIRMAN: On what basis? If they exempt up to \$50,000, they must assume that there is some taxable surplus, profit, gain, or whatever it may be.

MR. MASON: I cannot say it would not follow, as one is sitting here, that that would not have been the necessary result. I have no quarrel with your statement, except that one knows from the proceedings that took place why it was done. They had to find a certain amount of money and, quite illogically in my submission, they did it in this way.

"There is no comparable legislation in Great Britain affecting reciprocal exchanges as reciprocal exchanges do not exist there but apparently unincorporated companies are not liable to taxation."

I have not tried to follow out here the British method of taxation, because we have no comparable thing in Britain, and I have left it at that. My recollection from the reading of the material, which I have done at great length, is that that is accurate; but I find it is very difficult to construe a good deal of the British legislation, which is composed on a different basis from ours.

"18. There is a manifest tendency on the part of the stock companies grouped in rating bureaus such as the Canadian Underwriters Association to make competition with them difficult. That association or its subsidiary had furnished agents, particularly in Ontario and Quebec, with plans and rating material upon which the local agents had to rely very largely in taking applications for policies. As a result of litigation which ended in 1940 it was held that the association or its subsidiary had copyright in rating schedules, rate books, etc., and generally speaking that the copyright in the plans





was the property of the association or its subsidiary. Following this in 1942 the association sent to large numbers of local agents printed material and forms of agreement the general effect of which was that if the agents would give 50 per cent of their business to members of the association for two years, and 75 per cent thereafter they would be entitled to a class A rating which would entitle them to an increase in the amount of certain commissions; that if they gave the members of the association 35 per cent of their business for the two-year period and 50 per cent thereafter they would be entitled to a class B rating and be entitled to use the plans and rating material of the association and its subsidiary; but that if they did not qualify for either class A or B they would be in class C and not entitled to use the plans and rating material of the association or its subsidiary. Litigation has been commenced against various agents unwilling to enter into such agreements to force them to return the plans and rating material supplied by the association or its subsidiary. The obvious purpose of this was to seek to increase the amount of insurance placed with the members of the association. It is one of the associations now active in endeavouring to curtail competition of mutual companies and reciprocal exchanges by having income and excess profits taxes imposed on them. Sufficient copies of the printed material mentioned above are not available to add to all copies of this submission but a copy will be filed with the Commission when representations are made on behalf of the exchanges before the Commission. It is submitted that far from assisting Canadian Underwriters Association in its attempt to obtain a virtual monopoly of the insurance business in Canada it is in the public interest that every fair means of competition



should be encouraged."

This paragraph has to do with a matter that has arisen only comparatively recently, but I do submit it is a matter that should be brought to the attention of the Commission. I gather from the supplementary brief that the joint stock companies, upon whose behalf the brief is filed, are the component parts of the Canadian Underwriters Association.

MR. PARKER: Would my learned friend pardon me for a moment. I notice that in addition to reading the brief he is making a rather extensive argument. In view of that I wonder if he would be good enough at this stage to tell me on what basis he considers the argument set forth in paragraph 18 relevant to the matter before this Commission, so we can judge the value of his argument.

MR. MASON: Yes, I will do that in a word. The brief on behalf of the joint stock companies emphasizes certain purposes for which this Commission is being asked to tax exchanges and mutuals. They say the country needs the money, and the reciprocals should pay; and they point in their supplementary brief a large number of things that they have done for the benefit of the common weal, and so on. I merely want to suggest to the board that the interests of the Canadian Underwriters Association, since we are competitors, may be of a different character; and that, as I see it, one of the purposes of the submissions which they are making is to interfere with or at least cut down the competition they now meet from the reciprocals and the mutuals by reason of the particular methods we adopt in our work in Canada.

The only point I want to make here is this, and I need not take time to go into it very deeply. Having established by certain litigation ownership to certain rating material,



Mr. Mason

plans and so on, the Canadian Underwriters Association then sent out to agents throughout Ontario and Quebec these proposals, which I will be glad to file with the Commission.

The first proposal was that if any agents would transact such an amount of business with them, if they would give the Canadian Underwriters Association 50 per cent of their total business for two years and then increase the percentage to 75 per cent, the association would give them an increased rate of commission and allow them the use of all their material.

I do not know whether you have had anything of this kind before you. The ability to refer to rating material and plans is an extremely important thing to an agent in a smaller place, or in fact in a city. Then they said, "If you do not get that amount, but you will give us 35 per cent for two years and then 50 per cent, then you do not get any increased commission but you get our rating material."

THE CHAIRMAN: The point of Mr. Parker's observation is whether this argument is going to be of much assistance to us in the task we have to perform. It deals with your competitors, but I do not see that it is advancing our cause particularly.

MR. MASON: If the Commission is not going to pay any attention to the portions of my learned friends' brief that are taken up --

THE CHAIRMAN: No, we have read their brief.

MR. MASON: That is my sole purpose in doing it. I want to indicate that there might be other reasons for the propositions that are being made by the joint stock companies and those which appear in the brief of my learned friends. Now the next paragraph of my brief follows:

"19. In 1942 the Special War Revenue Act was amended. Section 14 as enacted by section 5, 6 George VI provides:





'(1) That an insurance company, other than a Lloyd's association or a mutual company not carrying on the business of life insurance, or an exchange, shall pay a tax of 2 per centum upon the net premiums received by it in Canada, less net premiums paid for re-insurance;

'(2) That every Lloyd's association and every mutual company not carrying on the business of life insurance and not carrying on the business on the premium deposit plan shall pay a tax of 3 per centum upon the net premiums received by it in Canada less net premiums paid for re-insurance;

'(3) That every mutual company carrying on business on the premium deposit plan and every exchange shall pay a tax of 4 per centum upon the net premiums received by it in Canada.'"

MR. PARKER: The same argument will apply to this paragraph, as to whether this argument is relevant. We understand the argument, but what I should like to know is on what ground my learned friend makes it here.

THE CHAIRMAN: Perhaps Mr. Mason might make the argument and omit the reading of the sections.

MR. MASON: My task here is lightened very considerably by the brief filed by the joint stock companies, the main brief, because on page 11, paragraph (c), they say:

"That the recognition by parliament that reciprocals and mutuals enjoy an advantage over the stock companies, appearing from the differentiations in the premium tax, indicated by section 14 (1), (2) and (3) of the Special War Revenue Act, 6 and 7 Geo. VI, Chapter 32, Section 5, be eliminated as being in no wise an equalizing measure, and consequently that such sections be repealed; and/or that all insurers be put on



an equal tax footing."

"20. It is submitted that this discrimination should be removed and that the tax upon the net premiums of all companies associations and exchanges transacting the business of fire insurance in Canada should be upon the same percentage of net premiums. Section 4 of 6 George VI defines 'net premiums' in the case of mutuals carrying on business on the premium deposit plan and in the case of exchanges as being the actual net cost of the insurance to the insured during the taxation period, together with interest on excess of the premium deposit over such cost at the average rate earned by the company on its funds during the period. No similar charge for interest is made against stock companies and it is submitted that this constitutes an additional discrimination in favour of the stock companies against the mutuals mentioned and exchanges which should be removed."

We have been discriminated against in the past, since 1942, and my learned friends agree with me that that discrimination is improper and should be removed.

"21. In brief it is submitted:

"(1) That neither the provisions of the Income War Tax Act nor of the Excess Profits Tax Act should be extended to reciprocal exchanges for reasons inherent in the nature of the services performed by them as hereinbefore set out.

"(2) That their exemption from the provisions of these Acts in the past has been based upon adherence to sound principles of taxation.

"(3) That imposition of such taxes with respect to exchanges would mean double taxation; that exchanges have no profits and should not be subject to tax as the moneys are taxable in the hands of the subscribers.



"(4) That a reciprocal exchange is not a commercial venture for profit but merely the provision of mutual protection at cost.

"(5) That a reciprocal exchange is not an entity, has no money and is merely a place at which subscribers exchange contracts with one another.

"(6) That the rate of taxation imposed upon reciprocal exchanges under the Special War Revenue Act, as mentioned in the foregoing paragraph number 19, is much in excess of the rate imposed upon stock companies."

In closing, as I have said, I have not had time to examine with sufficient care the supplementary brief that has been filed by my learned friends, but I notice one observation that I should like to mention.

THE CHAIRMAN: Are you purporting to argue now? I should not think you should do that now. I think the procedure would be to have your client go in the box and be sworn and answer such questions as may be directed to him.

MR. MASON: I did not propose to do that. There was an observation here some place, that the contributors and participants were not one and the same; that is, in the joint stock companies' brief. All I want to say is that there is a complete identity in the case of an exchange. That is, the people who pay the money are the people who receive the portion of the money paid. There are no outsiders; there is complete identity.

That is all I wish to say at this time. As I have mentioned to you on more than one occasion, the whole form of organization is covered in the material at the back; and if there is any matter as to that, or any matter as to the practice of the exchanges, I think probably I can answer it; but





Mr. Mason  
Mr. Gerrish

if it is any matter of fact, Mr. Gerrish is here to answer it.

---

MR. V. M. GERRISH,

Canadian Representative,  
E. W. Brown Company,  
New York, N.Y.,  
having been duly sworn  
testified as follows:

MR. MASON: I may say that the attorney-in-fact for a number of these larger exchanges is E. W. Brown Company of New York, and Mr. Gerrish is his Canadian representative.

BY MR. PARKER:

Q. As Mr. Mason has said, you are the Canadian representative of the Brown Corporation, or whatever it is; the attorney-in-fact? A. Correct, sir.

Q. And as such you have charge of the clerical work, the office management and that sort of thing, in Canada?

A. That is right.

Q. How long have you been occupying that position?

A. Twenty-two years.

Q. So you are pretty familiar with the organization of this association? I take it that before you began business you got a licence, did you, from the federal department?

A. Yes, sir.

Q. Does that come under your direction, the application for and the securing of that licence? A. No, sir.

Q. Have you records relating to the application for the licence and the granting of it? I assume all these ten companies have licences from Ottawa? A. Yes, sir.

MR. MASON: He acts only for these six or seven.

MR. PARKER: I understand that.



Q. Have you among your papers or in your files the licence granted by the federal department? A. Yes, sir.

Q. Have you copies of the applications that were made for those licences; have you them? A. I would think not.

Q. Have you ever seen them? A. Not to my knowledge.

Q. You have seen the licences; they are all filed there? A. Yes.

Q. Who are the licensees mentioned in those documents? You have not a copy of them here, I suppose? A. No, sir.

Q. Could you furnish us with copies of those? A. Yes, sir.

Q. Speaking from your recollection, if you can -- I realize that you are dealing with a written document -- who is the licensee mentioned in them? A. My recollection is that when the original licences were issued by the Federal Department of Insurance, they were issued to subscribers at New York Reciprocal Underwriters or Individual Underwriters, as the case may be. My recollection is also that renewal licences have omitted any reference to "subscribers at" but for the sake of convenience, or something of that sort, have merely mentioned the name of the exchange.

Q. What I am getting at is this. Is it the exchange that is licensed to do business, under the name of a certain so-and-so, or is it 50 or 60, or whatever number it may be, different individuals who are licensed to carry on business in Canada? Which is it? A. The name of the exchange, prefaced by "subscribers at".

Q. But take the name of one of these, the New York Reciprocal Underwriters? A. Yes, sir.

Q. That is, the party that is licensed is the subscribers to the New York Reciprocal Underwriters, at such a place? A. No.



Q. How does it go? A. "Subscribers at New York Reciprocal Underwriters."

BY THE CHAIRMAN:

Q. Is the word "at"? A. The original licence used the word "at".

BY MR. PARKER:

Q. When was that issued? A. I think the original licence was issued in 1919.

Q. What about the current licence; how is that issued?  
A. No reference is made on current licences to the words "subscribers at".

Q. What is the thing that is licensed, then; the New York Reciprocal Underwriters? A. That is right.

Q. That is the thing, as we may call it, that is licensed, is it? A. That is right.

Q. And does that apply to the others as well? A. Yes, sir.

Q. But it is not the place that applies for that licence. You have been there twenty-two years, you say?

A. The original licence --

Q. I am not talking about the original licence; I am much more interested in the current licence. You have been there twenty-two years, so I take it that you would have some knowledge of the licences that have been issued from the time you went there, on? A. That is right.

Q. Taking any of them that you do recall, perhaps you do not recall them all, I assume an application was made for the licence by somebody? A. Yes, sir.

Q. That is correct, is it not? A. That is right.

Q. And did you have the supervision of those applications? You prepared that application at the time, did you? A. No, sir.





Q. For any of these renewals? A. No, sir.

Q. That was done where? A. From the head office of the attorney-in-fact corporation.

Q. But from your knowledge do you know who signed those applications? Were they signed by 40 or 50 different individuals, asking that they be licensed, or were they signed the same way the licences are issued, The New York Reciprocal Underwriters? A. Signed by the attorney-in-fact corporation.

Q. I know that is who it was signed by.

MR. MASON: That is what you asked him; who signed it.

BY MR. PARKER:

Q. In whose name was the application made? A. The attorney-in-fact corporation, for the exchange.

Q. He asked that a licence be issued to the exchange?  
A. That is right.

Q. He does not ask that a licence be issued to 40 or 50 different individuals, does he? A. No.

Q. Do you have to make -- and by "you" I mean this group of men -- do they make annual returns of any kind? A. Yes, sir.

Q. Of the amount of business done in Canada? A. Yes, sir.

Q. You have charge of the preparation and forwarding of those returns? A. Yes, sir.

Q. Who signs those returns? Who makes the returns?  
A. The attorney-in-fact corporation, in the name of the exchange.

Q. Have you copies of those returns? A. I have blank copies of the form of return.

Q. Have you a blank copy there that you can show me?  
A. Yes, sir.



Q. What I am getting at is, who really makes the return, whether it is the New York Underwriters or whether it is so many individual men. This is just a blank form furnished to you by the department to fill in? A. Yes, sir.

Q. Is there not a place for it to be signed? A. On the very last page.

Q. You say that the practice is for this to be signed by whom? A. The attorney-in-fact corporation, in the name of the chief agent in Canada.

Q. I did not quite get that? A. The chief agent in Canada is the registered name that is filed.

Q. The chief agent in Canada for what, or for whom? A. For the attorney-in-fact corporation.

Q. That is the Brown Corporation? A. That is right.

Q. That is the way those are signed? A. That is right.

Q. I have not gone through the report in detail, but does it contain a place and form so that there is inserted the name of every subscriber, or is it a general return setting forth the information as to the business done by all? A. A general return setting forth the business done by all.

Q. It is not segregated in the report? A. No.

Q. Did you have anything to do with the preparation of this brief which has been read? A. No, sir.

Q. That was your counsel, I suppose, who prepared that? A. I had nothing to do with the preparation of the brief.

Q. You do not take responsibility, then, for any statements of fact stated therein? A. No, sir.

Q. Have you read it carefully since you have been here? A. Yes, sir.

Q. Are you prepared, from your knowledge of the business, to say that the statements of fact, apart from the arguments



and inferences, are true? A. Yes, sir.

Q. There is one statement here; I am not quite sure whether it is a statement of fact or of law, or whether or not it is true in any case. In paragraph 3, page 2, I refer to the opening sentence. These questions are merely to try to clarify just what this means, because I do not know very much about this, and I am going to assume that some of the Commissioners are new to some of the details of this, and we are trying to help them. You say:

"As reciprocal insurance developed it became convenient to have a common agent or attorney who would transact the business of the exchange."

I suggest to you, or rather it would seem that there are two things there; that there is something called an exchange, which is quite different from what is said later on in the brief, to the effect that an exchange is merely an office place, a room like this, with chairs and tables and typewriters. They say that is the exchange. I do not think that is the way the word is used here, do you?

MR. MASON: With deference to my learned friend, I think I made that explanation to you, Mr. Chairman, as I went along.

MR. PARKER: Well, my learned friend made an argument on it, and that is the difficulty of having one man prepare a brief and somebody else giving evidence on it and discussing it. The other thing here is that that thing, the exchange, whatever it is, I am quite sure a plain office does not do business by itself. It is rather an inadequate sort of thing; but that exchange, whatever it is, does carry on business. Is that as you understand it?

THE WITNESS: Carries on business with its own members.





BY MR. PARKER:

Q. I am not interested in with whom it carries on business; just that it carries on business. It is an exchange carrying on business. You say it is something carrying on business with its own members, do you? A. It is a place at which the business of the members is transacted.

Q. Is the exchange merely a place, or is it an aggregation of people? A. It is a place.

Q. Or the activities of somebody enrolled in a sort of unit? Which is it? A. A place.

Q. Merely a place. That is your understanding? A. Yes, sir.

Q. Then on page 3 of the brief I see this:

"Theoretically the amount deposited by a subscriber need be only sufficient to take care of his portion of the cost of operating the exchange --"

Again I suppose that means operating this office?

A. Yes.

Q. It goes on:

"-- in which event there would be no money available for taxation in the hands of the attorney, but in practice it is found desirable --"

Why is it found desirable? What makes it desirable to make such a great over-deposit of more than is needed?

A. It would be very difficult in an underwriting sense to foresee the amount of losses which might be incurred.

Q. Yes, but this company does not operate in the ordinary underwriting sense; it does not do business, we are told by your counsel; they only exchange contracts with each other, as I understood the argument a moment ago.

A. Well, the contracts exchanged are contracts of indemnity.



Q. I understand that. But do you understand that they are carrying on business like ordinary joint stock companies, carrying on insurance business? A. No.

Q. In that particular way? A. No.

Q. They are not carrying on an insurance business?  
A. No.

Q. That is, the exchange is not, nor the individuals?  
A. Your question, sir, was "carrying on business in the same manner as the joint stock companies."

Q. In the sense that you are carrying on the insurance business. I did not mean the exact details, but the real fact. Are you carrying on business? Is this exchange thing carrying on business, or is it not? A. I cannot subscribe that it is.

Q. All right.

BY THE CHAIRMAN:

Q. Would it not be practicable to have the deposit made when the loss has been ascertained, rather than make the deposit first? A. It would be very impracticable.

Q. Why? The difficulty of collection? A. For two reasons. One is that there are several thousand members of various exchanges with which I am associated, and they are scattered in all the provinces of Canada and in all the states of the United States.

Q. That is merely a convenient way of collecting, is it?  
A. That is the reason it would be impracticable to do as you suggested.

BY MR. PARKER:

Q. But it is not a matter of absolute necessity, is it? That is, it could be done the other way, as far as the nature of the business is concerned? A. Oh, yes.



Q. It is only an administrative convenience to do it in this way? A. Yes.

BY MR. VAUGHAN:

Q. Has it not happened in certain years that pretty well all that deposit has been required; and in some years the amount of the deposit may be pretty well used, while in other years it may be only half used? It is the purpose of the full deposit to protect against what might happen in some unusual year? A. That is correct. There have been years in which the deposit has been fairly well entirely used up, which possibly confirms the reason I gave as to why the deposits in their size and character are now required.

BY MR. PARKER:

Q. Then go on a little further down the page, to paragraph 6. I am not going to keep you very long with this, but there you say, "the office operated by the subscribers." Look at the word "office". Does that mean, again, merely the physical office operated by the subscribers? As a matter of fact they do not operate the physical office at all. You operate that, do you not? You are in the office and the subscribers are not there at all, except I suppose only now and again?

MR. MASON: You have not read it all.

MR. PARKER: Is that not correct? The ordinary day-to-day operation of the office, which you are talking about here, is conducted by you and your staff, not by the subscribers. Is that not correct?

THE WITNESS: Only as a representative of the subscribers; as their employee. The subscriber employs the attorney-in-fact corporation to conduct the affairs, and I am employed by the attorney-in-fact corporation.





BY MR. ARNASON:

Q. Is there a considerable turnover in the membership of the various exchanges? A. No; very little.

Q. I was wondering whether the amount required as a deposit had any relationship to the possibility that there would be a change in membership from year to year, and whether that was the reason for that amount? A. No relation.

BY MR. PARKER:

Q. What I was trying to get at is the meaning of this brief. You say, "the office operated by the subscribers through the attorney." Do you really mean there what I would call the physical office, the typewriter and the chairs and the place where they are contained, or do you mean the business that is conducted in that place, when you are referring to the word "office"? A. I mean the physical equipment. At least that is my interpretation.

Q. And that thing is commonly known as the exchange; and that is the thing that applies for and gets a licence to do business with these physical assets. Does that make logic to you? A. It does not sound logical to me, sir.

Q. Then you go on and say, "and for that reason the assemblage of the subscribers." I suggest to you that there is the real meaning of the whole thing; that the subscribers are treated as a group, a unit, an association or whatever you care to call them. There is some sort of group acting together carrying on business in this office. Is that a fair way to put it to you, do you think? A. Yes.

Q. And you go on:

"--commonly known as an exchange with some additional name to identify the particular group."

I should read the line before that:



"--for that reason the assemblage of the subscribers in a particular group is commonly known as an exchange."

That is what I thought it was; the group or assemblage working together. It is known as the exchange? A. Yes, sir.

Q. You do not subscribe to the statement, or do you, that what is meant by the exchange is merely the place, the office in which you, for instance, carry on the business? That is a rather far-fetched view, in your opinion, is it not; or is it? A. I would not say so, sir. There has to be some place where this assemblage of subscribers transacts its business.

Q. I suggest to you, and perhaps this is a question of law which I should not put to you but which will have to be argued later on, that the type of business that is being carried on there is what perhaps lawyers might call an unregistered partnership?

MR. MASON: Surely my learned friend is not going to ask this witness whether the type of business is that of an unregistered partnership. That is purely a matter of law.

MR. PARKER: I introduced the question by anticipating such an objection.

THE CHAIRMAN: I am sure Mr. Mason could answer that, but I do not think the witness should be asked to do so.

MR. MASON: In the previous paragraph the language is, "commonly known as an exchange," which it is.

BY MR. PARKER:

Q. Then in paragraph 11 in page 4 you go on to say:

"It has become the practice of the attorneys to retain a portion of the subscriber's deposit by way of reserve."

How is that decided in practice, just how much will be retained? A. It is mentioned in the subscriber's agreement.



Q. It is decided by the advisory committee, within the limits of certain other sections in the agreement? A. That is right.

Q. You say it has become a practice to do that. It is a little more than a practice, is it not? They have to do it, in accordance with the terms of the agreement, or by some law, do they not? Is it necessary to hold back any money?

A. In accordance with the agreement it is necessary.

BY THE CHAIRMAN:

Q. As the "substantial surplus fund" to use the words in paragraph 11, increases in your exchange, do you reduce the initial deposit required? A. No.

Q. The rate is the same year after year? A. It is substantially the same year after year.

Q. Then what is the purpose of the substantial surplus fund? A. To take care of extraordinary, unforeseen, heavy claims.

BY MR. PARKER:

Q. I thought the over-deposit was intended for that, in the first place. You have eight or ten times the amount you expect will be required in the first place, do you not? A. Pardon?

Q. Each year you take a great deal more than you expect the losses to be in that year? A. Some more.

Q. Considerably more. How many times more than the actual estimated losses? A. Possibly four or five times.

Q. You take that in order to have something on hand for unexpected losses, do you not? A. Yes; but the deposits that are collected in that way, on becoming unused go into the subscriber's reserve fund, so it is the same money.





Q. Is there any limit to the amount of the reserve fund you want to set up? A. Yes, it is limited by the subscriber's agreement.

Q. What is the limit? Would you point out to me the clause in the agreement which says where the upper limit is reached? A. Paragraphs 48 and 49 should be read together in that respect.

Q. All right; we will have to read them at our leisure. Then this is clear, that these reserves and what we will call the over-deposits until such time as they are placed in the surplus funds, are they invested? A. Yes, to some extent.

Q. Well, I suppose to whatever extent is necessary in order to leave you enough for ordinary purposes? A. Yes, that is right.

Q. And that yields considerable income, that investment? Right? A. Well, I would not say considerable in relation to the premiums advanced.

Q. I did not say in relation to anything in particular; there is a substantial income from the investments, is there not? I do not care how much, whether it is \$10,000 or \$10,000,000. I am not interested in that, but I use the word "substantial"? A. Yes, I think that can be taken as correct.

Q. Then I would like to know just how those investments are made, and how the records are kept. Have you some Victory bonds, for instance, in any of those investments? A. Yes.

Q. Are those Victory bonds registered or bearer bonds? A. Bearer bonds, for the most part.

Q. Is there any record in your office, the office which you keep, that will show that such and such a Victory bond belongs to such and such a subscriber? A. No.



Q. Is there any ledger account kept showing that there is so much money which has been received from John Jones, and so much out of his deposits has been used for expenses and so much has been used for the surplus fund, and that he has so much left to his credit? A. Yes.

Q. A ledger account shows that? A. Yes.

Q. And does that same ledger account show how much of his portion of the money you still have in your hands is invested in Victory bonds? A. There is one item on the ledger sheet which shows the subscriber's share in the interest income.

Q. What is that? A. There is an item on the ledger sheet for each subscriber which shows his share of the interest income from the investments, if that answers your question.

Q. Let us come back to the point when, we will say, you have given an order to buy so many Victory bonds; let us say \$25,000 worth. Who makes the subscription; who is the buyer on the application form? A. The attorney-in-fact corporation, with the approval of the advisory committee.

Q. On behalf of whom? A. Of the advisory committee, the trustees.

Q. They are the real purchasers, as far as the application for the Victory bonds are concerned? A. The advisory committee as such are not the purchasers. The advisory committee, they are the trustees for the funds of all the subscribers, naturally authorized or otherwise the management or attorney-in-fact to make the purchase or not.

Q. But in making the purchase to make up the \$25,000, do you go through your books carefully and say, "Now, Jones has \$5,000 that I can use, and this other fellow has \$2,000,



and somebody else has less, and with all that we can make up the pot." Is that how it is done? A. No, sir.

Q. How is it done? A. The funds in the bank that are owned by all the subscribers.

Q. In a common bank account? A. Yes, sir.

Q. In the name of? What is the name of the bank account? A. The New York Reciprocal Underwriters.

Q. The bank account is in the name of the New York Reciprocal Underwriters, and I suppose you are the signing power who issues cheques? A. One of them.

Q. Who else? A. Several members, several officers of the attorney-in-fact corporation.

Q. At any rate, a group of you have authority to issue cheques on this common account which is kept in the name of the exchange? A. Subject to the approval of the advisory committee or trustees.

Q. But in fact it is kept in the name of the exchange? A. That is right. There are two bank accounts, one called a trustees' account, in which the bulk of the funds are naturally kept; the other called the New York Reciprocal Underwriters.

Q. Who is the depositor; the New York Reciprocal Underwriters? Is that the name which appears on the deposit slips as the depositor? A. Further designated by the name of the account. The New York Reciprocal Underwriters might have two bank accounts, one called the trustees' account --

Q. I say that is how it is designated? A. Yes, sir.

Q. And the proper officers issue cheques on them?

A. That is right.

Q. And you have this common bank account made up, you say, of moneys belonging to a great many different people?





A. That is right.

Q. You issue a cheque to buy one block of bonds. Do you figure out, as you buy, whose money you are using, and buy so much for each member, or do you simply issue a cheque on behalf of all of them? A. The bonds are purchased on behalf of them all.

Q. Then having received a quantity of bonds, we will say there is \$25,000 worth of bonds, what do you do with them then? How are they allocated to the individuals? A. The par value of the bonds in the aggregate, plus any cash which may be in the bank, is continuously a credit to all subscribers in a pre-determined ratio.

Q. And when the coupons are clipped and you have some extra deposit, you again adjust each member's account so he will get his proper share of that interest? A. That is right.

Q. You have a variety of investments? They are not all Victory bonds? A. They are substantially government bonds.

Q. There is some variation, at any rate? A. Yes.

Q. And is all the money belonging to one subscriber always invested in the same type of bonds, or is it mixed up? A. He participates in his share of all types of investments.

Q. Then on page 4 of the brief, in paragraph 9, I just want to make sure I understand this:

"If a man insures his business in a stock insurance company the premium he pays is deducted from the income of his business as a business expense."

You know that to be so, do you? A. Yes.

Q. That is, when he pays out a \$100 premium, that is allowed to him as a business expense? A. That is right.



Q. Then you go on:

"If he is a subscriber in an exchange the moneys paid by him and not needed are returned to him and taxed to him as additional income --"

When a man who becomes a subscriber pays out, we will not say a premium but this deposit, does he charge that all up as an expense at the time? A. I would say so.

Q. Do you know whether there is any uniformity on that at all? A. Not having run a joint stock company business of any sort, I cannot say I know or not. I would think, if I may be permitted to say that, that if a subscriber pays an advance sum to the exchange, it would be a business expense in the same sense as if he paid a premium to a joint stock company; but if and when he is returned a part of that advance deposit, then that would be reducing the initial deposit by the sum of the return, and therefore he is taxed accordingly. That would be my thought and understanding as to how it probably works out.

Q. The part which you retain in the surplus fund and do not pay back to him, how does he treat that? Having taken his credit for the whole thing when he pays it in -- it is not a premium, as I understand your contention to be, but this deposit is treated as an expense at the time it is made. Then when he gets his portion back you say that is treated as income to him? A. Or a reduction of that particular initial expense.

Q. Then what about the part you keep and that he does not get back? A. I do not know what the subscribers do. That is their own business. I do not know.

BY MR. ELLIOTT:

Q. May I ask a question? When interest is received on



these securities it is divided among each of the subscribers' accounts? A. Correct.

Q. And presumably the proceeds of the investment, unless needed to pay losses, are reinvested in securities? A. Yes.

Q. And the interest returned on this reinvestment is again apportioned to the accounts of the subscribers? A. That is right.

Q. And in the meantime, as far as you know, your subscribers do not report these various allocations of interest to their accounts as income received during that period?

A. I would say not, because they only get one accounting from us a year, as of the end of the calendar year.

Q. Then do you know whether in each year they show as income changes in their accounts with you, either as income or expense each year; that is, changes in the balance of their accounts? A. I couldn't answer that question definitely without being advised officially as to what subscribers do in regard to the manipulation or operation of their own books. I would assume that they probably do.

Q. They are notified by you each year? A. Yes.

Q. As to the amount of their balance? A. That is right.

BY MR. VAUGHAN:

Q. Referring to those reserves again, when they reach a certain point do they stay there; that is, with respect to the subscriber, or do they keep increasing all the time?

A. No, sir. The subscribers' agreement provides for a limit in the amount of reserve which can be accumulated in the name of any subscriber.

Q. And when the reserve reaches that amount, is the unrequired part of the deposit repaid fully? A. Yes, that





is paid. Any excess of reserves, determined as such at the end of the year in accordance with the agreement, is returned to the subscribers in cash, plus all of their unused deposits for that year.

BY THE CHAIRMAN:

Q. Any return made to the income tax authorities in regard to either the allocation or the return payments? A. No, sir.

BY MR. PARKER:

Q. Out of this over-all deposit that you receive, let us follow that right through, there are certain office expenditures deducted from each man's deposit? A. Yes, sir.

Q. And his share of the losses is taken out? A. Yes, sir.

Q. And what is the first thing you set aside by way of reserve out of what is left? A. It all goes into the subscribers' accounts or remains in the subscribers' accounts.

Q. It is to their credit? A. Yes.

Q. But there comes a time when you apportion a certain part of that to a reserve, is there not? A. No, not in accordance with the set-up.

Q. I thought the agreement provided for a certain reserve to be set aside. Do you not do that? A. The agreement does provide that --

Q. Note clause 29(a) of your agreement. What does that mean, and what do you do under that? These are the powers and duties of the advisory committee? A. Yes.

Q. Let me read it:

"Establish and maintain a reserve for contingencies, to be accumulated out of current income and used at its discretion for the benefit of all subscribers."



Do you take any action under this clause? A. I think the way you read it is not entirely correct. I think you have to read the first sentence:

"Each advisory committee shall have full power and discretion to --"

Q. That is right. Now I am asking you if they do it?

A. Yes, they do.

Q. Do they take action under that clause? A. Yes, they do.

Q. Then tell us what action they take by way of maintaining a reserve for contingencies. How do you work under that? A. There is a contingency reserve established.

Q. On what basis? How is the amount arrived at, and what is done with it? A. It is determined on a certain percentage of the advance premium deposits, or maybe a certain percentage of the unused premium deposits for the year.

Q. But you must be careful there. There are no premium deposits? A. Advance deposits.

Q. Just stick to the word "deposits" so we will not get mixed up. The deposit is made? A. Yes.

Q. You have paid your office expenses out of that, and you have paid your losses? A. Yes, sir.

Q. I assume an advisory committee, acting under the authority given to it under the agreement, proceeds to do something in connection with what is set out in paragraph 29(a), namely for the maintenance of a reserve. Tell me how they go about that? A. At some meeting of the advisory committee they will authorize the attorney-in-fact to set aside certain funds for contingency reserves.

Q. Can you tell me how they arrive at the amount? Is it a certain percentage of the gross deposit, or a certain



percentage of what is left over? A. It may be arrived at in various ways.

Q. How is it, to your knowledge? A. I cannot answer that question.

Q. At all events they do direct that a certain sum be set aside? A. Yes.

BY THE CHAIRMAN:

Q. The paragraph refers to your "current income"; that is paragraph 29(a). What do you regard as your current income? A. The advance deposits; the deposits advanced by subscribers.

Q. Do you take into consideration any investment income in that? A. Not in establishing contingency reserves or any such other reserves as the committee may direct.

Q. Then I am to understand that the term "income" refers to deposits made by your members? A. In respect to that particular clause, yes.

Q. You do not tie that up in any way with premiums?  
A. No.

BY MR. ARNASON:

Q. Would it not be more appropriate to refer to it as current receipts, if it includes both deposits and investment income? A. Possibly.

BY MR. PARKER:

Q. You will be having another misnomer in this contract if you are not careful.

BY MR. NADEAU:

Q. How do you show that current income in your annual statement to your subscribers? Under which item do you show it, this current income, in your annual income statement to your subscribers? A. It is shown as earned deposits or





earned premiums, as the case may be.

BY MR. PARKER:

Q. This contingency reserve, the amount to be set aside, as you say is decided by the advisory committee? A. That is right.

Q. What I am trying to find out is whether they say, "We will set aside a lump sum, namely \$5,000 or \$10,000," as the case may be, or whether it is a percentage of something? A. Yes, it is a percentage.

Q. It is a percentage of something? A. Yes.

Q. And when you apply that percentage to all the accounts, you get a certain amount? A. That is right.

Q. Having arrived at the amount in that way, is each subscriber's share in that reserve credited to him in the ledger account? A. Yes.

Q. Every time? A. Yes, sir.

Q. That is the way it is kept? A. Yes, sir.

Q. You are sure of that? A. Yes, sir.

Q. In addition to that contingency reserve, is there any other kind of reserve set aside? What is the next one?

A. Well, there is the unearned deposit as of the end of the year, sometimes called the unearned premium reserve.

Q. That is the balance getting ready to be handed back, is it? A. No.

Q. What is this unearned premium reserve, so-called?

A. If I may explain that in further detail, if a subscriber makes that advance premium, say of \$100 for a policy of insurance running for one year; if he makes that deposit and receives the policy as of July 1, for instance; then as of the end of December, when the books of the exchange are closed, there is \$500 unearned, it would be returned to him and his



insurance would be cancelled as of that date.

Q. Are these records all kept so that each man knows his share of all those things at any given time? A. That is right.

Q. Now, any other reserve apart from those two? A. Not that I know of, sir.

BY THE CHAIRMAN:

Q. What about Section 48; what is referred to as an operating reserve? A. That is the proportion of the subscriber's unused deposits which is placed to his credit.

Q. Is that separate from the contingency reserve?

MR. PARKER: I was coming to that operating reserve.

Q. What is that? A. That is the unused portion of the subscriber's advance deposit that is not returned to him in cash.

Q. That goes to create a so-called surplus fund? A. A reserve fund.

Q. I think it is referred to in the brief as a surplus fund. Is that the same thing? A. Yes.

BY THE CHAIRMAN:

Q. But it is over and above the contingency reserve, is it not? A. Yes; with certain modifications, that the subscriber's operating reserve of course includes all reserves which he has to his credit. He may have his operating reserve earmarked perhaps 96 per cent of it for operating reserve and 4 per cent for contingency reserve, or something of that sort.

BY MR. PARKER:

Q. Is that worked out on a percentage basis too?

A. The operating reserve?

Q. I know it is laid down in these rules that within certain limits they must do it; but within those limits they



have a discretion? A. Yes.

Q. Are there any other reserves, now? A. Not that I know of.

Q. Everything else goes back to the subscriber? A. Yes, sir.

BY MR. ELLIOTT:

Q. I am not clear on this yet. Section 29(a) provides that a reserve or contingency is to be accumulated. Paragraph 48 provides that an operating reserve shall be established as a credit item in the separate account of each subscriber. Do you say that operating reserve in the separate account of each subscriber included the contingency reserve accumulated out of current income? A. Yes.

BY THE CHAIRMAN:

Q. Why is it considered necessary, then, to have two separate requirements, one to empower the advisory committee to accumulate a contingency reserve, and another to require an operating reserve? A. The establishment of a contingent reserve enables a greater reserve to be established than would otherwise be done if the operating reserve alone was just considered.

Q. But the operating reserve includes a contingency reserve? A. That is correct; but the point is that if the amount of reserve were confined entirely to the operating reserve, it might be four premiums or something of that sort; whereas if the contingency reserve is also permitted, it might amount to one premium. So that in the subscriber's one reserve account there is shown a record of his total reserves, four premiums of the total being operating reserve and one premium possibly being contingency reserve. Perhaps I misled you in saying that the operating reserve does include the contingency reserve. I probably should have said that the reserves





of the subscriber, all in one item, as far as his ledger sheet is concerned, are probably earmarked so much for operating reserve and so much for contingency reserve.

Q. And the sum of the amounts earmarked in the individual subscriber's account for contingency reserve -- do they all added up constitute this reserve for contingencies which the advisory committee are to accumulate out of current income? A. I am not sure that I have your question in mind.

Q. As I understand it, you told me that in each subscriber's account there was an item "reserve", a certain part of which was earmarked contingency reserve? A. That is right.

Q. Then if you add up the parts of the individual member's account earmarked contingency reserve and the other part earmarked for other things -- taken together, would they constitute the reserve mentioned in paragraph 29(a)? A. No. That all added up would be considerably in excess of the contingency.

BY THE CHAIRMAN:

Q. Put it in this way. What does the contingency reserve in section 29(a) contemplate? A. It contemplates having funds on hand which would be available for extraordinary losses which might be conceived in amounts which possibly even the subscriber's operating reserve would not meet.

Q. Is that apart from the operating reserve? A. Yes, but it is all in one reserve as far as the subscriber's ledger is concerned.

Q. I understand that; but the contingency reserve is the broader term which embraces the other reserves you speak of? A. No, sir.



MR. PARKER: I think they are separate in part and together in part.

MR. NADEAU: Perhaps if we had the annual statement we would be in a better position to understand that.

MR. PARKER: I was going to suggest this, that perhaps the best way would be if, through Mr. Mason, we could be furnished with perhaps unidentified samples of members' ledger accounts, which will show all this sort of thing and how they are kept.

MR. MASON: I can say this much for the benefit of the Commission, that the operating reserve is a very large and substantial amount in any exchange. The contingency reserve is a very unimportant amount in comparison.

MR. PARKER: Does the greater include the less, or is one in addition to the other?

MR. MASON: As I understand it, there is an operating reserve under section 48. That is compulsory in the general provisions. Then there is authority to the advisory committee to set up this contingency reserve, which in practice is only a very small thing. What the witness is saying, as I understand it, is that whatever there may be in the operating reserve, that is a large thing; and whatever there may be in the contingency reserve, that is a small thing, but they both go to the credit of the individual subscriber. I think that is all there is to it.

MR. ARNASON: Is it fair to say that section 48 gives general authority to set up such reserves as are necessary, whereas section 29(a) merely establishes the principle that there shall be the reserves?

MR. MASON: Apparently it is intended, because it is merely permissive in certain contingencies which might arise.





As a matter of fact the contingency reserve in these companies does not amount to anything substantial at all.

MR. PARKER: We are not particularly interested in the amount of either one, but only in the principle. They set up these reserves and use them for certain purposes, as a part of their method of operating.

THE WITNESS: They have discretion to do that.

BY MR. PARKER:

Q. There is one other paragraph in this connection to which I want to call your attention; that is paragraph 35, concerning the powers and duties:

"Take into its own charge and keeping all securities owned by its office --"

Who is the owner of the securities? It provides that the advisory committee should take into its charge --

"--and all moneys received by the attorney-in-fact for account of said office --"

Again, is that this business of the furniture and the typewriters? Are they the people having money sent to them, or is it somebody else? A. Well, the attorney-in-fact corporation or individual, as the case may be, is authorized by the advisory committee to receive certain funds such as advance payments or deposits from subscribers. Such funds are placed in the charge and the keeping of the advisory committee, with the exception of such funds as such committee may authorize the attorney-in-fact to use.

Q. I am particularly interested in "the securities owned by its office." I am trying to find out who that is. You are talking there about securities owned by the office, by the advisory committee's office. What is the unit that you are referring to there; what does that contemplate? A. Do you





want to know what the word "office" means there?

Q. I want to know, if I can -- if it is a question of law and there is any objection to it I will not press it -- who is the owner of the securities that the advisory committee may take into its charge? A. All of the subscribers.

Q. And all of the subscribers, taken together, is referred to as an office? A. That is right.

Q. Is that right? Do not say yes to something you do not mean. A. It is referred to as an exchange.

Q. Would it be the same to use the word "exchange" there instead of "office"? Does it convey the same idea to you? A. Yes.

Q. Perhaps this is a question of the construction of a written document. In the last part of that same paragraph it says:

"Take into its own charge and keeping all securities owned by its office and all moneys received by the attorney-in-fact for account of said office, after deduction therefrom by said attorney of his compensation and such other funds as he may retain to meet fees, taxes, losses, expenses, and liquidation of subscribers' accounts, together with any other funds which the advisory committee may direct him to retain."

You say that all represents the money and securities of subscribers? A. That is right.

Q. That is your contention, whether right or wrong? A. That is correct.

Q. Then will you turn to page 7 of the brief and see if you can enlighten me a little on this:

"The very favourable loss experience and the high earnings of stock companies in Canada show how immune the premium rate regulating procedure of those companies is to



considerations of interest to the policy holders. An insurance organization with share capital can be taxed on the profit or gain enjoyed by the shareholders without reaching the policy holder while, on the other hand, there is no way in which a purely mutual insurance organization or exchange can be taxed without increasing the cost of insurance to the members."

You understand that proposition as laid down there?

A. I do.

Q. Let us look at it. I suggest that I quite agree with you that part of this proposition is sound, that in the reciprocals, such as yours, the more taxes you have to pay the higher the cost of insurance, in that there will be a less amount returned. I am not quite sure of the other half of the proposition, though, that an ordinary joint stock company can be subjected to any amount of taxation and it will not be reflected in the rate of premium they will have to charge. That is the proposition, is it not? A. Not being the author of this particular paragraph I am not sure that I should say yes or no to that. It may be a matter of law.

Q. I do not know. It is a matter of practice right in the office, I should think; can you help us on that at all? If my recollection serves me at all, there is a certain brief before us which takes issue with that proposition, and I should like some light on it from your side while we are at it. As an insurance man; as a man who is familiar with the operations of your reciprocals, you know how taxes affect you if and when they are imposed. Are you perhaps, not equally familiar but somewhat familiar with that same incidence of taxation as imposed upon a joint stock company; or do you not feel competent to discuss that? A. I do not feel competent to discuss the point.



Q. Then can you tell me this. I suppose reciprocals which you represent have to in some way decide how large the deposit will be which they will require in order to carry on business satisfactorily? A. That is right.

Q. Are you sufficiently familiar with the rate making, we will call it, to use a word perhaps analogous to a joint stock company -- are you familiar with what factors are taken into consideration, the main factors at any rate, that the reciprocals take into consideration in fixing the amount of their deposits? A. The reciprocals follow the same rate making basis the joint stock companies do.

Q. The same general factors are common to both? A. Yes.

Q. Such as losses? A. No, not necessarily.

Q. Or estimated losses? Give us one or two main factors? A. Construction, protection, occupancy and exposure of the property to be insured. Those are the four basic things.

Q. Do they take into consideration the municipal, provincial and other taxation? Is that a factor? A. If so, a very negligible one.

Q. Is it a factor? A. No.

Q. Even municipal taxes? A. No.

Q. Not a factor in fixing rates by reciprocals? A. No.

Q. Is the probable cost of writing the insurance, of getting members, and office expenses taken into consideration? A. Yes.

Q. And the operating expenses? A. Yes.

Q. You will have to fix a rate which will cover that? A. Yes.

Q. And the necessary and proper reserves? A. Yes.

Q. The statutory reserves, if there are any, have to be taken into consideration, I take it? A. Well, the statutory





reserves of course are a percentage of advance premiums; therefore the lower your premium or the higher your advance deposits, the reserves are in proportion, if that is answering your question. I am not sure that it is.

Q. I do not want to go into this any further than is necessary. I am trying to get some light on what are the factors that the reciprocals take into consideration in fixing the amount of their deposits; and the only one I can get so far is the office expenses. What else? There must be something else? A. Expected loss.

Q. That is what I say; expected losses? A. Sure.

Q. Anything else? You say no taxes of any kind? A. No.

Q. Do you mean that? A. Yes, I do.

Q. Then if they were subject to income tax it would not affect the rate. Is that what you mean? A. It would not necessarily affect the rate of the initial advance deposit, but it might affect --

Q. It would affect the amount which would be available to pay back? A. That is right.

Q. In other words it affects the actual cost, or what we might call --perhaps you do not agree with us -- the actual premium. Why is that not true with the joint stock companies, then? Can you see anything that would enable you to answer one way or the other? A. As I see it, it would not necessarily affect the premium cost for that year to the joint stock company members.

Q. I do not suggest an immediate result. I do not say it is something that will work instanter, but I do suggest it is the tendency that the more you put up the income tax and pile it on to joint stock companies, that sooner or later, and sometimes pretty soon, ultimately the inevitable result



will be higher rates. Do you agree with that, or do you not?

A. Yes, basically I do.

Q. You do? A. Yes, I do, basically.

Q. I do not want you to agree with it, now, if you have not carefully thought it through. I do not want you to commit yourself to any snap opinion. If you say you have not thought of that, or thought it out, say so. A. It is a perfectly logical situation.

Q. I suggest that it is, but I do not know whether it is or not. I think perhaps there are those who will dispute you on that. That is your opinion, at any rate? A. I agree.

Q. As an experienced reciprocal man? A. Yes, sir.

BY MR. ELLIOTT:

Q. In what way is the income tax taken into account in establishing either the rates of the joint stock company or your own deposits? Just in what precise way is that taken into account? A. I am not in a position to answer that question from the point of view of the joint stock companies. In view of the fact that in the statutes there are no income or excess profits taxes assessed to reciprocal exchanges, naturally that has never been a factor in the determination as to the amount of advance premium to be charged.

Q. And what about the premium tax and the special war taxes? A. In what respect?

Q. Is that taken into account in deciding rates of deposits? A. No, sir, because the premium tax is based on a percentage of the premiums or advance deposits received.

BY THE CHAIRMAN:

Q. That does not affect the amount of the advance deposit? A. No, sir.



BY MR. PARKER:

Q. Then turn to page 9 of your brief for a moment. I want to call attention to a question which has been discussed briefly, I think, between the Chairman and Mr. Mason during the reading of the brief. You quote this finding from the United States, and what bothers me there is as to why it is quoted in this brief, because it seems to me that the result of that inquiry is that mutuals were taxed anyway, including reciprocals. Am I right or wrong? It is true that they got certain deductions; it is true that having taken all those deductions, they then got an exemption, but it seemed to me that what remained -- what bothered me was this, that unless they are an association, a unit, an assemblage, a group -- I do not care what you call them but unless they are a group of some kind which in law was considered a taxpayer, then I do not see why they set out to provide a list of deductions, and further I cannot understand why an exemption would apply to anybody but a taxpayer. Can you clarify that for me? A. No, sir.

Q. You cannot? A. No, sir.

Q. It seems to me as if it is quoted for that purpose, according to this it would seem that in the United States this type of company is a taxpayer; but if you cannot help us any we need not carry on with that. Now, are you familiar with the argument which is raised by the reference to the Special War Revenue Act? A. Yes, sir.

Q. And the premium tax? A. Yes, sir.

Q. Perhaps you can clarify that, then. Do you know on what basis the premium tax is calculated for the reciprocals? A. Yes.

Q. And do you know on what basis it is calculated for the joint stock companies? A. Yes.





Q. And for the stock mutuals and for every type that has to pay that tax? Are you familiar with them all? A. Only inasmuch as it is mentioned and defined and explained in this brief.

Q. We will not bother you with them all; we will take the reciprocals and the joint stock companies. You are familiar with the basis on which those two are calculated?

A. Yes, sir.

Q. In the one case, I understand the reciprocals pay what percentage? A. Four per cent.

Q. And the joint stock companies? A. Two per cent.

Q. In your case it is 4 per cent on what? On the net premium, is it? A. That is right.

Q. And the joint stock companies pay 2 per cent on -- ? A. The same thing.

Q. The net premium? A. Yes.

Q. That is what I want. Is the net premium on which the reciprocals pay 4 per cent calculated on the same basis as the corresponding net premium on which the joint stock companies pay 2 per cent? If you do not know, all right.

MR. MASON: Obviously it depends upon the interpretation of the statute. It is the statute of 1942.

THE CHAIRMAN: Will the witness answer the question as to how he calculates his net premium for that tax purpose?

MR. MASON: Yes, but that is defined in the statute also.

MR. PARKER: I am not sure that it is in the statute.

MR. MASON: It is in the amendment which was passed in 1942.

THE CHAIRMAN: What is the practice? How does he, for this reciprocal, calculate that particular amount on which the tax is 4 per cent?



MR. PARKER: He might calculate it as it is laid down in a statute; I do not know.

THE CHAIRMAN: It is calculated on the net premium. How do you get at that?

THE WITNESS: On the net cost to the subscriber.

BY THE CHAIRMAN:

Q. That is the total deposit, less what? A. Loss return premiums due to rate reductions or cancellations, of course.

Q. Operating expenses? A. No. Less returns to the subscriber in so far as it reduces his net cost for the year.

Q. Less reserves? A. No, not less reserves.

BY MR. ELLIOTT:

Q. Do the returns to the subscriber include both interest and everything credited to him? A. For the calculation of income tax, for income tax purposes, yes; that is right. It is based upon his net cost.

Q. The amount returnable or allotted to the subscriber will be affected by the revenue income of the investments of the exchange? A. Yes.

Q. So that to the extent that these investment incomes are returned to the subscriber, that will reduce the net cost to the subscriber? A. Yes.

Q. And will increase the returns to the subscriber, and therefore reduce the net cost to the subscriber? A. Yes.

Q. And your premium tax is computed on the net cost to the subscriber? A. That is right.

Q. Which means, then, absorbed deposits, I mean the total deposits plus other income, less any deposits that do not apply to that period, say any deposits that apply to subsequent periods. You gave us the example of a deposit of \$1,000 in respect to a one-year period, for instance? A. Yes.



Q. Unearned deposits would be deducted from total deposits? A. Yes, that is right. Would you pardon me if I gave you another example? It might clear it all up.

Q. Yes, do give us an example. A. Let us take the case of a subscriber who takes out a contract of insurance as of January 1, and pays \$1,000 advance deposit. At the end of that year possibly 60 per cent of that has been absorbed for losses and expenses of a character and kind, leaving \$400 or 40 per cent in the account of the subscriber. The premium tax in that case would be based upon \$600, or the \$1,000 which he paid less the amount credited to his account after all losses had been paid, which amount would be \$400. Therefore the premium tax in that case would be based upon \$600.

Q. And that \$400 covers expenses, losses and so on, less income from investments? A. That is right.

Q. That is apportioned to him? A. Yes.

BY THE CHAIRMAN:

Q. So we would have to add the income from investments to the \$400 before you could make up the net premium, would you not? A. Yes, that is taken into consideration.

Q. That is the way it has to be done? A. Yes.

THE CHAIRMAN: I think this is a good time to adjourn, until 2.15 this afternoon.

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---The Commission adjourned at 12.30 p.m. to meet again at 2.15 p.m.





The Commission resumed at 2.15 p.m.

Examination of Mr. V. M. Gerrish continued

BY MR. PARKER:

Q. Mr. Gerrish, I was trying to verify the basis of calculation on which the 4 per cent premium was paid, and I asked you if you could prepare a concise statement and read it into the record; have you done that? A. Yes.

Q. Then will you state on the record how it is calculated? A. Do you wish me to read it?

Q. Yes. A. "Tax on Net Premiums; In the case of an exchange 'net premiums' means the actual cost of the insurance to the insured during the taxation period together with interest on the excess of the premium deposit over the net cost at the average rate earned during the said period."

Q. And have you given an illustration of it?

A. Example:

\$1,000 premium deposit
<u>400 unused portion</u>
\$ 600 at 4 per cent - \$2,400....."

Q. In other words, the returnable part? A. Yes, sir. Assuming the \$400 unused portion is invested and that the average rate of return is 3 per cent, the interest on the \$400 will be \$12, which at 4 per cent would be 48 cents, and the total tax would be \$24.48.

Q. Now, that is the basis on which these reciprocals for whom you are speaking today have been paying in recent years the so-called premium tax under the provisions of the Special War Revenue Act? A. Correct.

Q. Is that right? A. Yes.

Q. In the agreement attached to your brief there is



provision for the election of an advisory committee; is that right? A. Yes.

Q. Do I understand correctly that that advisory committee is elected at the annual meeting of all subscribers? A. Yes.

Q. And is there an annual meeting of the subscribers? A. Yes.

Q. Where is that meeting usually held? A. At the office of the attorney-in-fact.

Q. Were no meetings held at your office in Toronto? A. In the case of one exchange, yes, because that office is the head office of the attorney-in-fact.

Q. In other words, the head office is usually in the United States? A. That is right.

Q. Perhaps you can tell me--perhaps it is still an interpretation of the agreement--but must all members of the advisory committee be subscribers under that type of agreement? A. Yes, sir.

Q. Is that one hundred per cent correct? A. Yes.

Q. I thought there was a provision in there that any officer of a group of which a member is a corporation was eligible to be elected as a member of the advisory committee? A. I am sorry, sir. I am assuming that an officer of a limited company is the same as the company.

Q. With that limitation--if it is a limitation--every member of the advisory committee is a subscriber? A. Yes, sir.

Q. Do you carry on re-insurance? A. Yes, sir.

Q. Would you tell us how that branch of your business is operated? A. We have a general Lloyds re-insurance treaty which I might call the re-insurance portion of every amount of insurance we accept.



Q. Is the treaty a written document? A. That is right.

Q. Have you a copy of that? A. No, sir.

Q. Could you supply a copy? Will you consult with your counsel now; and unless there is a good reason why you cannot supply document, I would like to have it filed. Now, in working out the cost of the insurance--that \$600 item you refer to in your illustration--I presume that the premiums you pay for re-insurance are included as part of the cost? A. Yes, sir.

Q. To the extent to which you re-insure.

MR. MASON: If my friend will pardon me, that expression "to re-insure" may be a little ambiguous on the notes.

MR. PARKER: I am using it in the sense he is using it.

MR. MASON: That might mean that the exchange, or the subscribers at the exchange, re-insure other people, which they do not.

THE CHAIRMAN: Oh, no.

BY MR. PARKER:

Q. Re-insure part of your old obligations. To the extent that you re-insure, and pay for it, the members or subscribers of this exchange are relieved of a corresponding liability? A. That is right.

Q. Does that require any adjustment in the amount returnable; how does that affect the amount returnable?

A. It becomes a part of the expense the same as any other item of expense.

Q. That is to say, a part of this money is used as expense, but at the same time the company is relieved as to obligation. I should think there should be a credit.

A. There is a credit in this respect: if a fire loss was





incurred, part of which was paid by the re-insurance, subscribers would not be absorbing as great a share of that loss as if there was no re-insurance.

Q. They would get the credit out of it on a smaller share of the loss? A. The returns are greater.

Q. A subscriber, having signed one of these agreements, becomes a subscriber -- that is not automatically an insurance policy? A. No, sir.

Q. Is there a written application signed following the agreement for a policy of insurance? A. Not necessarily.

Q. Is there sometimes? A. In the case of a subscriber --

Q. A new subscriber? A. No, in the case of a subscriber who lives in some city outside of the head office he writes in and asks that the insurance be covered where he lives in the office of the attorney-in-fact; he may telephone.

Q. Is there, as a part of the operation of this exchange, a formal application for the policy used by the exchange? A. No, sir.

Q. None at all? A. No.

Q. It may be an informal letter saying that someone would like to join up, or words to that effect; or it could be a telephone call? A. Yes.

Q. Having received the application, either by letter or telephone call, or in any other way, is a policy issued? A. Under the subscribers' agreement.

Q. Supposing he says it is O.K., he is a suitable person to insure, the contract of insurance is issued? A. That is right.

Q. Have you a sample of that formal contract which



is used by these reciprocals with you? A. No. I have not one, sir. May I illustrate?

Q. Yes. A. It is subject to the statutory conditions of the land the same as any other fire insurance policy.

Q. All the statutory conditions apply to the policies issued by whom -- who issues those policies? A. The attorney-in-fact signs them for subscribers at that particular exchange that issues the policy.

Q. Does that purport to be a verbatim quotation from the document? A. No, I am speaking from memory.

Q. I wonder if you would say that again so that I can get it. A. Perhaps I cannot say the same words twice.

Q. It is signed by the attorney-in-fact for whom? A. The policy of insurance is signed by the attorney-in-fact on behalf of the subscribers who constitute the membership of the particular exchange involved.

THE CHAIRMAN: Did you omit the word "at"?

THE WITNESS: Not intentionally.

BY MR. PARKER:

Q. Did you put it in intentionally the first time? ... Yes.

Q. It should be there? A. I think I used the words "on behalf of" instead of "at".

Q. Now, is there anything in the policy to indicate to that insured person who his insurers are? A. Yes.

Q. Are they set forth in the schedule, or is there a list attached, so that he can judge as to who his insurers are in case he gets a loss? A. The individual names?

Q. Yes. A. No, sir.

Q. Is there anything on the policy to indicate whether he can look to two or two hundred responsible



people to pay his loss? A. There is nothing on the policy to indicate that he can look to any specific member.

Q. What does he get to indicate that he has a good safe party to carry his insurance? He is putting up a large sum of money, he may have a heavy loss, and he may find out that he has got a lot of penniless fellow members. What information does he get? What assurance does he get?

MR. MASON: He does not get any penniless members.

MR. VAUGHAN: Outside of the policy, is there any list of the subscribers who are carrying the insurance?

THE WITNESS: Lists of subscribers are sent to any subscriber who asks.

BY THE CHAIRMAN:

Q. How does a policy holder know whom he is dealing with? A. He does not know unless he asks for the names.

Q. It might be one, two, or three, or any number?

A. Of course, under the Insurance Act there must be at least a certain number before an exchange can be organized, and it runs into the hundreds.

MR. MASON: There is something in the agreement that has some reference to it.

BY MR. PARKER:

Q. That is merely about the office. It does not show what annual income a subscriber gets. He may get it if he asks for it; as a rule, in practice, he does not.

A. That is right. They probably change from day to day or week to week; it would not be practicable.

BY THE CHAIRMAN:

Q. His faith is based on the attorney-in-fact?

A. To what extent?

Q. His insurance. He does not know, otherwise, who





is insuring him. He must be relying on the attorney-in-fact. A. Yes, I think so.

MR. PARKER: Or on the general reputation of the exchange.

BY MR. PARKER:

Q. I have one more question to ask and I am through. Coming to the investment accounts, I see that these exchanges in many cases have their head offices in the United States? A. In many cases, yes.

Q. And a very great proportion of their business is done in the United States? A. Yes.

Q. What would the ratio of Canadian business be to United States business -- would it be 1 to 10 per cent, or more than that? A. I think the ratio of total business of the associated reciprocal exchanges is perhaps nearer 15 per cent than 10 per cent.

MR. MASON: I am wondering if the witness had in mind what the question was directed to; I understood it was the proportion of the Canadian business to the total business.

THE WITNESS: To the total business.

MR. PARKER: Fifteen per cent and 85 per cent.

THE WITNESS: Roughly.

BY MR. PARKER:

Q. Now, when investments are made, are separate investments listed, or are separate investments made for the Canadian members as distinct from the United States members--two separate systems kept--or are they jumbled together? A. The answer to the first part of the question is, no.

Q. They are not kept separate? A. No.

Q. What is the answer to the second part? A. All subscribers are considered as belonging to the organization,



whether they are located in Canada or the United States.

Q. They are considered as one. They are considered the investments of one organization. A. No, sir, I did not say that. All subscribers are considered in the same category, if I may put it that way, irrespective of whether they live in Canada or the United States.

Q. You said something about "organization". Perhaps you did not intend to. A. I withdraw that, if I did.

Q. Each Canadian subscriber gets his proper share of the interest of the investments earned as a whole from the entire field? A. That is right.

Q. Then, are their taxes paid by anyone in the United States for any of the subscribers? How are your American taxes taken care of? A. Taxes are a part of the general expense and, assessed against all subscribers.

Q. Whose general expense? A. The subscribers, all subscribers.

Q. Taken as a unit? A. That is right.

Q. Are they not apportioned to each individual subscriber, to the general expenses? A. Yes, I said that they were charged against each subscriber in a certain ratio.

MR. PARKER: I think that is all I have to ask, Mr. Chairman, but I would like to make it clear that I think the Commission ought to have the following documents: first, sample copies of individual members' statements which are rendered annually. We should have one of each of the companies, without disclosing the name. That will show us the form and manner in which the accounts are kept; second, the general financial statement, if there is such, which is produced at the annual meeting--I am not sure there is one--but something analogous to a directors'



report to the shareholders at large. I do not know how many will be required -- whether they should cover more than one year, as a sample, or whether they should go back three or four years. I should think that one would be enlightening. I don't want to put these people to too much inconvenience.

THE CHAIRMAN: Shall we say since 1939?

MR. NADEAU: Are you referring to the annual statement mentioned in paragraph 17 of the agreement?

MR. PARKER: I am speaking of the statement rendered to an individual -- yes, that is paragraph 17:

"In January of each year render to us a statement showing a summary of collective transactions of each office at which we inter-insured during the preceding calendar year, and also a statement of our separate account at each such office made up as of the end of said calendar year."

I want those two. I am limiting that to the companies doing business in Canada.

MR. MASON: Yes. There are two I could not get.

MR. PARKER: I think we should have four or five.

THE CHAIRMAN: More in the nature of a sample.

MR. PARKER: I think, as I mentioned this morning, we should have a copy of the application for the current licences to do business in Canada; and, fourthly, I should like compared copies or certified copies of the licences, in each of the five or six companies, currently in force; fifth, I should like a copy of any written application--you tell me there is none--perhaps you might find one written application for a policy of insurance after a subscriber becomes a member; and finally, I want a sample of the policies, and I should like one or two -- not only





a sample of the blank policy -- but I should like complete copies of one or two that have been signed. If you could do that, we would know beyond any question of doubt just how they are issued.

THE WITNESS: Are you asking for the name of a particular subscriber?

MR. PARKER: I do not care about the name of the particular subscriber, that is confidential; but you can call the subscriber A. I want the exchange and the attorney-in-fact.

MR. MASON: May I be clear about this matter? I understand that my friend wants a copy of the financial statement in connection with each exchange, for what year?

MR. PARKER: 1939 to 1944 inclusive.

THE CHAIRMAN: Will that be difficult to obtain?

MR. MASON: They are not obtainable here; we would have to obtain them from New York.

THE CHAIRMAN: So long as we have a sample, 1939 and 1944 would cover what we want.

THE WITNESS: What is required is a sample of an individual account of a member.

THE CHAIRMAN: Under clause 17 of the contract.

MR. MASON: Yes. I was going to add: a statement referred to in paragraph 17 -- so that they do not overlap. Now, you want a copy of the application for each licence. For what year?

MR. PARKER: The ones currently in force.

MR. MASON: I cannot say definitely that we have that. We may or we may not, but in any event it can be got from the superintendent here. The next thing you want is a copy of the agreement with Lloyds to which the witness has referred. My friend wants a sample of a policy, of an



actual policy, not of a formal policy. If I can get that from four or five exchanges, that should be ample.

THE CHAIRMAN: Yes.

MR. MASON: Then, he wants certified copies of licences; certified by whom?

MR. PARKER: Certified by yourself. Any certified copy.

THE CHAIRMAN: By the witness. We want something dependable as a true copy.

MR. MASON: If my friend refers to a copy of any application, I do not know what is meant by that. I understand my friend has in mind that there may be some formal written application in use.

THE CHAIRMAN: The witness says no.

MR. MASON: If so, my friend wants it produced over a period of years. People may have written in from here, there, and everywhere.

MR. PARKER: If there is none --

THE WITNESS: I stated that there is not any. May I speak again of the request for a copy of the Lloyds treaty? It is a very voluminous document. I presume, as do most of Lloyds contracts, it contains the names of many hundreds of individuals, and in many other respects it is a voluminous document. It would require making a complete copy of it, but it can be done.

MR. PARKER: Are blank copies available?

THE WITNESS: No, it is a special contract drawn up and is certified as true, and it ends giving a general basis rather than endeavouring to submit a complete --

MR. PARKER: I suppose you have your original office copy?

THE WITNESS: That is right.



MR. PARKER: I suppose they are all the same for each company?

THE WITNESS: There is just one.

THE CHAIRMAN: We can make some arrangement and if we need to verify some document we can get Mr. Parker to inspect it, and we can return the original.

MR. PARKER: Would you feel safe in permitting the Commissioners to inspect the original?

MR. MASON: At the moment I do not know where it is. I assume that it is in New York.

THE WITNESS: Yes, that is right. What I was going to suggest, if we can secure the original, and I suppose we can, is that I might show it to Mr. Parker and he could decide what portions he wants filed, and they could be copied.

MR. PARKER: How about making a photostatic copy?

MR. MASON: My friend knows what is in these documents. What is the use of making a photostatic copy?

THE CHAIRMAN: I think that if the witness will refer to the definition as regards Lloyds policy and will give us the information there that will be all we require.

MR. PARKER: We will see how the document is executed. There is one more question. In a policy of insurance, when it is issued, how is it stated, is it at the beginning of the policy, is it insured with the undersigned so and so, or hereby insured so and so; tell me how it is worded?

THE WITNESS: I prefer that you get that when you get a copy of the policy.

MR. MASON: Would it be of any assistance to the Commission to have the numbers of subscribers at these various exchanges? The only reason I mention that is that the witness said there were several thousand, and





as a matter of fact there are not several thousand in respect of any one exchange. I have a list here that was furnished to the Department of Finance on May 15, 1944 which deals with the last figures available, and there, in respect of the seven which are grouped about the middle of the memorandum, they run 281 as a minimum and 1,440 as a maximum.

THE CHAIRMAN: I think that statement will be quite sufficient.

MR. MASON: One thing more, in connection with the definition of net premiums which is referred to. In my friend's summary submission which is printed, you will find as appendix C the text of the statute, and I merely observe that when you get down to 13 (f) the word "company" is used. The word "company" is defined in the interpretation section as including everything -- exchanges, and everything else.

MR. PARKER: Then there is a reference made to taxation in the United States. Are we to take it that there is no taxation whatever on these exchanges in the United States?

THE WITNESS: Oh, yes, there is a premium tax the same as there is in Canada.

MR. PARKER: And that applies on the net premiums such as you illustrated?

THE CHAIRMAN: Is that rate in force?

THE WITNESS: I cannot tell you the exact taxing set up of the exchanges in the United States. I know they are taxes that are comparable in net.

THE CHAIRMAN: There is no income tax such as we are discussing here.

THE WITNESS: Other than mentioned in the brief this morning.



THE CHAIRMAN: Then it might be well to have a note of how these exchanges are taxed.

MR. MASON: The reference in the memorandum is to the actual tax by the American statute, and by reference to that annotated part you will find the whole thing. If it is convenient I will have it typed later and copies made for the use of the Commission.

BY MR. MANN:

Q. Mr. Parker's examination was so exhaustive that I shall be short. The re-insurance placed at Lloyds is by agreement? A. Yes.

Q. Have you any other faculty for re-insurance at all? A. Other than that?

Q. There is no other type of re-insurance you acquire except treaty re-insurance? A. No.

Q. I am aware that in some of the provinces these exchanges do not accept re-insurance. Do they accept re-insurance in any of the provinces from each other? A. Yes.

Q. Which provinces? A. Ontario.

Q. Among themselves they do accept re-insurance. A. That is right.

Q. And the respective exchanges, I take it, charge the extent of the re-insurance in their respective favour, as part of the expense? A. That is correct.

Q. And the insurance company receives the premium, and naturally that goes into the accounts of receipts? A. That is correct.

Q. Outside of twenty exchanges that are now named in this brief, do these exchanges accept re-insurance? A. What is the question?

Q. Outside of those that are mentioned here in the



brief, do they accept re-insurance? A. Not to my knowledge.

Q. It is limited entirely to the twenty exchanges?

A. As a matter of fact, it is limited to a greater extent than that. The Ontario amendment to the insurance law permits re-insurance among exchanges doing the same class of business.

Q. Could they not do re-insuring among themselves?

A. Provided they are doing the same class of business.

Q. Exactly. They reinsure among themselves?

A. Yes.

Q. Are you familiar with the war damage provisions of insurance? A. Yes.

Q. And you are familiar with the instructions, I take it, which come from the Minister of Finance relative to those who may insure and the remuneration they may get and so on? A. Yes.

Q. Has war damage insurance been accepted by you -- when I say "by you" I refer to any of these exchanges?

A. In what respect?

Q. Have they insured against war damage? A. No.

Q. They have not insured at all, in any respect?

A. No.

Q. Have they place any war damage insurance anywhere?

A. Yes, one of the exchanges listed here was appointed the fiscal agent of the Dominion Government to act for the sale and handling of war damage insurance contracts.

Q. One of these exchanges? A. Yes.

Q. And you are aware of the remuneration to which they were entitled -- 5 per cent? A. That is right.

Q. That is the remuneration that one of these institutions got? A. Yes.





Q. And that formed part of its intake? A. That is right.

Q. But officially none of these exchanges assumed any war damage obligation? A. No.

Q. So they did not get the  $2\frac{1}{2}$  per cent? A. No.

Q. They got the 5 per cent? A. Yes.

MR. PARKER: Five per cent on what?

BY MR. MANN:

Q. Five per cent commission on the premium, was it not? A. That is right.

Q. Do you know of a company, speaking of the twenty exchanges, known as the Arex Indemnity Company? A. That is not a reciprocal exchange.

Q. Do you know of that corporation? A. Yes, I do.

Q. That is a joint stock corporation? A. Yes.

Q. A casualty and automobile insurance corporation? A. Yes.

Q. To whom does it belong? A. The stock is owned by subscribers at associated exchanges and certain other individuals.

Q. Some of the stock of the Arex Indemnity Company is owned by these reciprocal exchanges?

MR. MASON: He did not say that. He said by the subscribers.

Q BY MR. MANN:

Q. Is it owned by the individual subscribers of the exchanges, or is it owned by the groups? A. Well, it is owned by the subscribers to this extent that such funds as they have in their reserve account in part consists of the stock of the Arex Indemnity Company.

Q. Exactly. The Arex Indemnity Company was organized for and on behalf of the groups of exchanges within which



are the individuals who compose the exchanges? A. That is not correct.

Q. What is correct? A. It was organized for the benefit of subscribers who now carry our insurance at the associated reciprocal exchanges.

Q. Organized by whom? A. Advisory committees of the associated reciprocal exchanges, groups of individuals, subscribers to the attorney-in-fact corporation.

Q. Exactly. And the moneys to pay for the capital stock came out of these reserves; is that what you said?

A. In part.

THE CHAIRMAN: It is an investment?

THE WITNESS: Yes.

BY MR. MANN:

Q. And the dividends are paid--if there are any dividends--into the respective interests some of whom are the groups and some of whom are the individuals? A. Yes.

Q. Do you know who controls the Arex Indemnity Company? A. Yes, the majority of the capital stock is owned by subscribers at associated reciprocal exchanges.

Q. Can you tell me to what extent the reciprocal exchanges control the capital stock? A. Well, the reciprocal exchanges are not an entity and do not own or control anything.

Q. As groups? A. I am not sure that I understand your question.

Q. If I understood you correctly you said some of the reciprocal exchanges and some of the individual underwriters own some of the capital stock of Arex Indemnity Company, or that it was held for their benefit?

A. I did not say that, sir.

Q. What did you say? A. I said that the capital



stock of the Arex Indemnity Company is owned in part by subscriber associated reciprocal exchanges and other individuals.

Q. And how is that stock held? A. What do you mean, sir?

Q. How is the certificate of the stock held?

A. I take it the attorney-in-fact corporation holds certificates of stock belonging to subscribers at each of the exchanges.

THE CHAIRMAN: Where is the office?

THE WITNESS: New York City.

BY MR. MANN:

Q. Has the Arex Indemnity Company annual meetings?

A. Yes.

Q. And does the attorney-in-fact vote at those annual meetings? A. No.

Q. Who does vote at the annual meetings in respect of the capital stock? A. I will amend my statement. The attorney-in-fact corporation does vote in respect of the company stock owned by subscribers of the associated reciprocal exchanges.

Q. Is the majority of stock of Arex Indemnity Company owned for the benefit of, for or on behalf of, and acquired by funds which were funds of any of the groups or the combination of the groups? A. Yes, in the same manner as a bond would be purchased.

Q. You stated a moment ago, in answer to Mr. Parker, that the statutory conditions in respect of the provinces apply where you do business and apply to your policies. The statutory conditions are maintained and held in force and not waived by your companies? A. That is right.

Q. They are maintained in force? A. That is right.





Q. Both as respects the surety and as respects the suretor? A. Correct.

Q. Any province in which you do business? A. To the best of my knowledge and belief, that is correct.

Q. Are you aware as to whether, on behalf of these reciprocal exchanges, the attorney-in-fact makes any return of income in connection with the Income War Tax Act?

A. Yes.

Q. Does he? A. He does.

Q. He declares under the Income War Tax Act that he owns some money, or has received some income? A. Yes.

Q. That is all.

BY THE CHAIRMAN:

Q. Do you state that the exemptive section of the Income War Tax Act is applicable to you or covers your enterprise? A. May I ask you to repeat that question?

Q. Do you consider that the exemptive clause, paragraph 4 of the Income War Tax Act, applies to your enterprise? A. I am afraid I cannot tell you what clause 4 is at the moment.

Q. "The income of mutual corporations not having a capital represented by shares, no part of the income of which inures to the profit of any member thereof...." Is that the section you rely on? A. I would say, yes.

Q. Do you consider it is necessary exemption for taxation? A. Yes.

Q. Also, do you consider you would be exempt if that section were repealed? A. I think that is a matter of law, sir, that I will not pass on.

Q. What is the advantage to the insurer in your particular form of enterprise? We have heard all morning about what is the advantage of that enterprise; what is



your selling point? A. The chief advantage is in the matter of cost of insurance.

MR. ARNASON: Do you mean that the member feels he will get his insurance at cost?

THE WITNESS: Yes. May I expound on that for a moment? Assuming that the advance premium charged is similar or the same as is charged by joint stock companies, it has been the experience over the past sixty-five years that the associated reciprocal exchanges with which I am identified have returned between forty and sixty per cent of those advance premiums or deposits, sometimes less, sometimes more, but a fair average over sixty odd years will be between forty and sixty per cent; so that assuming the initial charge is the same as is charged by joint stock companies, then the subscriber holding a policy of insurance at these particular exchanges would receive insurance at approximately forty, fifty or sixty per cent less than he would pay through the joint stock company plan.

BY THE CHAIRMAN:

Q. Which I suppose you would interpret to be an element of profit? A. To whom?

Q. To the joint stock company. A. No, sir, I would not infer that at all.

MR. MASON: With deference to the Commissioner, I should be glad if the witness might continue his answer to the chairman's question before going on with something else. You asked him what he felt were the advantages of this form of insurance to the subscriber. He has mentioned one, and I would appreciate it if you would permit him, to say what the advantages are as he sees them. I cannot give evidence, but I have acted in these matters since 1916, and the matter he has been mentioning may be important to many



people, but in the minds of many people there are other points which are more important. The witness has been asked what he thinks are the advantages to a subscriber of this sort of protection. Now, tell the Commissioner what you think they are.

THE WITNESS: The chief advantage as I have mentioned is the matter of cost. Another advantage is that we have developed a rather scientific fire prevention inspection service which we think is a rather preferred service of that character to the members who insure with us. Thirdly, we have been pioneers in the introduction of certain coverages which, perhaps, have been a little loath to be appreciated by companies whose sole motive is the profit motive. Fourth, looking at the matter in the general sense, there has been the introduction of an extremely healthy competition which has kept rates in Canada and the United States from going to what might be termed out of bounds. Fifth, in the matter of strength of indemnity it is shown that the resources back of the contract indemnity in relation to insurance at risk are possibly twice what the resources are in relation to the same amount of insurance at risk as shown in the statements in other types of insurance companies or underwriting organizations. I think that summarizes the chief advantages.

MR. MASON: Will you tell the Commission what you require before permitting a subscriber to be a subscriber to your exchange?

THE WITNESS: Basically no firm or individual is eligible for subscribership at the associated reciprocal exchanges unless they have at least a net worth in their own business as shown by statements of assets or liabilities of \$100,000.





THE CHAIRMAN: Would you say that one of the advantages is *its* exclusiveness?

THE WITNESS: I wanted to say that, but I did not think it sounded well.

MR. MASON: What else?

THE WITNESS: Among the fireproof underwriters, which is one of the associated reciprocal exchanges mentioned, the physical risk must be of fire resistant construction and equipped with a standard system of automatic sprinklers. At the New York reciprocal underwriters the risks must be equipped with automatic sprinklers, not necessarily a building of fire resisting construction, but it must be of substantial brick, joist or mill construction, and so on down the line to affiliate underwriters, which requires neither fire resisting construction nor automatic sprinkler protection; but none of the exchanges write in any form any risk which the underwriters think to be ultra hazardous, such as oil refineries, veneer plants, and things of that sort -- grain elevators and so on.

BY MR. ELLIOTT:

Q. You do not underwrite any rural or agricultural projects? A. No, sir, we do not underwrite insurance where there is absence of public protection.

Q. I am interested in the annual meeting of the subscribers. You told Mr. Parker that it was held in the office of the attorney-in-fact corporation? A. That is right.

Q. Has it a chairman? A. The chairman is elected when the meeting is called by the members present.

Q. And they proceed to vote seven members as an advisory committee; is that right? A. Proceed to do what, sir?



Q. To vote to elect seven members as an advisory committee? A. That is right.

Q. Is any other business transacted at the meeting of the subscribers except the voting of the members of the advisory committee? A. Oh, yes, the auditors reports are submitted.

Q. By whom are they submitted? A. The secretary of the meeting, who is also elected at the time the members assemble.

Q. Whom does he get them from? A. The attorney-in-fact corporation.

Q. Are there any other business proceedings?  
A. Confirmation of the actions taken by the advisory committee meetings held throughout the year.

Q. Are those confirmations by vote of the subscribers?  
A. That is right.

Q. Then, the new advisory committee, having been elected, or the old one having been reelected, has certain duties and powers as laid down in the contract?  
A. That is right.

Q. It meets from time to time? A. That is right.

Q. It does more than advise, does it not? A. Yes, I suppose they would exercise the obligations and the rights ~~that~~ any board of directors might exercise. In addition to that, of course, their chief importance is that they are trustees for that fund.

Q. Are they responsible to this annual meeting of subscribers who regard them as sort of representing that meeting? A. No, they are not responsible to the annual meeting of subscribers other than as I said before, that at the annual meeting of subscribers any actions taken by the advisory committee at their meetings, since the last ,



annual meeting, are confirmed by the subscribers.

Q. If they are not responsible to the annual meeting, and they do not act on its behalf, on whose behalf are they acting? A. I am not sure that I understand the meaning of your question, sir, regarding their being responsible.

Q. On whose behalf are they acting? A. They are responsible to the subscribers because they are elected by them.

Q. You say they are elected by the subscribers; they are elected at an annual meeting by the subscribers?

A. That is right.

Q. I am asking you whether they are responsible to that annual meeting of the subscribers? A. I would not say that they are responsible to the meeting of the subscribers; they are responsible to the subscribers which, I think, is different.

Q. Would you explain that difference? A. Under the terms of the agreement the subscribers at their annual meeting elect the advisory committee, the duties and powers of such committee being outlined in the agreement; and I would say that the committees are, therefore, responsible to the subscribers. If it is a convenient means of reporting their activities at the annual meeting of the subscribers, to that extent, possibly, the committees are responsible to the meeting; but it does not necessarily follow that they are responsible to the meeting; they are responsible to the subscribers.

Q. You mean by reason of the contract that each subscriber appoints the advisory committee to perform the duties and have the obligations? A. That is right.

Q. And in reporting to the annual meeting they are, in fact, in a convenient way, reporting to each subscriber





attending the meeting? A. Yes.

Q. How do you count the vote -- I presume by a majority vote? A. Forty-three of the subscribers' agreement.

Q. That confirmation is not necessarily from each individual subscriber? A. Yes, if I understand your question correctly.

MR. MASON: Each subscriber present.

THE WITNESS: Shall I read the clause, sir?

MR. MASON: I do not want to interrupt, but the powers and duties of the advisory committee are set out in 20, 26 and paragraph 40.

MR. ELLIOTT: I was less interested in getting the clause setting forth the powers and duties than I was in having the witness expound on what they consisted. Thank you very much.

BY MR. MANN:

Q. May I be permitted one question? I observe in paragraph 43 of the general provisions relative to your annual meeting that it is fixed for the first Tuesday and Wednesday of each year? A. The first Tuesday in February.

Q. Yes, the first Tuesday in February. Now, if I am right in my interpretation, anybody who does not attend automatically creates the chairman of the advisory committee his proxy? A. Yes.

Q. Is there a notice given of the annual meeting, or is this the annual meeting? A. No. Notice is sent out.

Q. How long ahead of time? A. Oh, one month or six weeks.

Q. In what form? A. A printed notice by order of the advisory committee.

Q. Does that, in fact, happen? A. Yes, it definit-



ely happens.

Q. Have you attended any of these annual meetings?

A. Yes.

Q. As a matter of fact, what would you say has been the number who attended the last two or three annual meetings? A. I have no objection to answering that question, but it is my opinion that it is irrelevant.

MR. MASON: That is not for you to determine.

MR. MANN: My question is: how many of the subscribers attend the annual meeting as a rule and, for example, how many have attended the last three or four annual meetings?

THE CHAIRMAN: I do not think that is of very much assistance.

BY MR. MANN:

Q. If you do not think I should ask the witness that question, I will ask this one: is it not a fact that the votes at the annual meeting generally speaking are controlled by the attorney-in-fact? A. No.

Q. It is not a fact? A. No, sir.

Q. Then, you see how relevant my question is: how many individual subscribers usually attend that meeting? And then it is a pure mathematical calculation. A. If no subscribers attended the meeting the attorney-in-fact would have no vote.

Q. What about the proxy? A. He does not get the proxy.

Q. If the chairman of the advisory committee did not happen to be there, he could not vote? A. Yes.

Q. But if he does happen to be there and is all alone -- A. The chairman of the advisory committee has no connection with the attorney-in-fact.



Q. I understand that. The chairman of the advisory committee, if he is at a meeting, and is there alone, he has an automatic proxy by virtue of forty-three.

THE CHAIRMAN: Is it a meeting if there is only one person present?

MR. MANN: Let us say three; that would be a meeting, I take it?

THE WITNESS: If I understood your comment originally, sir, you made mention of the fact that because of the absence of most subscribers in person the attorney-in-fact controlled the votes.

BY MR. MANN:

Q. I may have been guilty of a lapse. I was referring to the chairman of the advisory committee. If I was guilty of that lapse, I apologize. A. That is my recollection.

Q. I refer to the chairman of the advisory committee. A. That is correct.

Q. What is correct? A. That the chairman of the advisory committee automatically holds the proxy of any subscriber who does not attend in person.

Q. And habitually is it not fair to say that the chairman of the advisory committee really does, in fact, control that? A. I think it is correct in view of the fact that if there are a thousand members of the exchange the chances are that there are not over five hundred in attendance.

THE CHAIRMAN: I assume that the meeting is about as well attended as the ordinary stock meeting?

MR. MANN: I cannot assume it, Mr. Chairman.

BY MR. NADEAU:

Q. Does the attorney-in-fact hold any fixed assets on behalf of the subscribers? A. The only assets which





the attorney-in-fact holds are certain funds authorized by the advisory committee, which funds are usually authorized to an amount to enable him to expedite the running of the business, if you wish to call it that, such as paying nominal fire losses, expenses, salaries, wages.

Q. There is no fixed asset at all? A. No.

Q. Is there any equipment besides the office furniture? A. No.

Q. On what basis do you calculate the amount that the subscribers have to deposit with your exchange?

A. We use a basic rating schedule for determining the deposit in the case of each risk, and the amount of insurance.

Q. Is there any fixed rate? A. Only as dictated by our underwriting judgment based upon experience or a rating or schedule which we may use.

Q. Is there a ratio between the amount and the value of the property insured? A. I think it is determined that the rate per \$100 insurance is 10 cents per annum; then that rate would apply for each \$100 of insurance irrespective of the amount of insurance required, so that obviously twice the amount of insurance would provide twice the advance premium deposit.

Q. Will you tell me what are the functions of the deputies mentioned in paragraph 15 of your agreement?

A. In the organization which, perhaps, becomes rather large the attorney-in-fact might not find it practicable to exercise all the business of the attorney-in-fact himself, and he might depute others to assist in the expedition of carrying out the affairs.

Q. He might depute subscribers? A. No.

Witness dismissed.



MR. PARKER: That closes that brief for the time being. Will you let us have the documents later?

MR. MASON: It will take some little time but I will do my best to expedite matters.

MR. PARKER: Send the documents to the registrar, not to me. We will now proceed with Factory Mutuals.

THE CHAIRMAN: Do you propose to deal with the briefs in this case?

MR. PARKER: I will pass this on to Mr. Gray.

SUBMISSION ON BEHALF OF FACTORY MUTUAL COMPANIES

MR. EVAN GRAY: Mr. Chairman and gentlemen, I have with me for the Factory Mutual Companies Mr. H. T. Freeman, who is the President of the Manufacturers Mutual Fire Insurance Company, one of the Factory Mutual group, on whose behalf this submission is made. He comes from the home office of the company in Providence, Rhode Island, and he will be a witness presently on behalf of his company. May I say a word of introduction in regard to Mr. Freeman. If you will look at this printed summary--and it may be that not all members of the Commission have this, and I will ask the registrar to make sure that they have--you will find as the appendix on the inside of the back cover a list of the Associated Factory Mutual Companies and some information to which we may refer later. You will see there the Manufacturers Mutual Fire Insurance Company, as old as any, and the largest of the group in relation to business, and it is also the member of the company which has the largest proportion of its business in Canada. That proportion is about 8 per cent of its total business. The remainder is in the United States of America. Mr. Freeman was born in this Factory



Mutual system, since he is the son of the former president, the late John R. Freeman, who was the president of the group now represented by the Manufacturers Mutual Fire Insurance Companies for many years, and earlier of the Associated Factory Mutuals business in Canada and the United States. The Associated Companies have a joint affairs committee. You will hear something more about that in connection with the Joint Inspection Bureau which is operated under the direction of this joint affairs committee on behalf of all the companies and does, in that connection, a very important and substantial part of the service which these companies render to their members. This joint affairs committee has named Mr. Freeman as chairman of their Law and Legislation Committee and it is by his direction and under his supervision that the briefs submitted here have been prepared, and he will presently verify the allegations which they contain under oath.

May I make one observation in regard to that? Any allegations found in these briefs which refer to the conduct of the insurance business of Canada by joint stock insurance companies are made on the personal responsibility of counsel who submitted the briefs. That is my responsibility, and I shall be pleased if any question arises on this matter, to offer myself as a witness in support of the allegations which the briefs contain. Mr. Freeman is not to be presumed to have personal responsibility for the statements as to how joint stock companies conduct their business in Canada. Apart from that, anything found in the briefs may properly be accepted as his responsibility.

Now, I have also with me Mr. J. P. McD. Costigan of Toronto, who is the chief agent in respect of





Associated Factory Mutuals in Canada. That term "chief agent" is a statutory expression, and its meaning is limited to the duties described in the statute, The British and Foreign Insurance Companies Act. Its function is really the representation in Canada of a company having its head office outside of Canada for the service of notice of process in legal proceedings, and also the custodian of the records in Canada which are required by the statute to be kept here. He is not an executive, necessarily, of any of the companies, except the Manufacturers Mutual Fire Insurance Company, of which he is one of the principal executive officers in Canada.

Now, I first ask you to make a correction in the main submission of the Factory Mutuals--that is the one in the grey cover--on page seventeen. About the middle of the page, below the table which shows figures there is a paragraph beginning "this figure of \$633,000....". I wish to ask you to strike out the last sentence in that paragraph. I will explain the reason for that correction at the appropriate time.

MR. PARKER: You wish to delete it altogether, do you?

MR. GRAY: Please do that.

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Now, Mr. Chairman, one sees in the proceedings of this commission representation of that well-known statement that of the making of briefs there is no end. But I gather from the instructions given this morning that so far as the reading of briefs is concerned, at least, you intend that there shall be an end.

THE CHAIRMAN: We would like to dispense with as much of that as possible.

MR. GRAY: Precisely. So in order to meet that view I wish to present this case and the matter of certain points which I think arise and are the principal points of the submission, without reading either the summary or the main submission. But I do intend, if by then your patience is not exhausted, to ask for leave to read the reply to the brief of the joint stock insurers, for the reason, I suggest, that the reading of that will shorten the presentation materially. "all understand, and I am sure you, Mr. Chairman, will agree. that it is sometimes shorter and more accurate to put a point in written form than extemporaneously, and orally. Therefore my present plan, subject to what you might wish to have done, is to present a general outline of the summary and the main submission, and then to ask Mr. Freeman to give his evidence to the Commission. Then when he is finished I hope to have the privilege of reading the reply to the joint stock insurers and the Income Tax Association's submissions.

MR. PARKER: Does my learned friend mean by that, that after he has read the reply Mr. Freeman will again be a witness in respect to matters to which he will reply?

MR. GRAY: Of course he is available to the Commission, if the Commission wishes to hear him.

THE CHAIRMAN: It is more argumentative than factual, it seems to me.



MR. GRAY: Of course my learned friend will be at perfect liberty to examine the witness on any point in the supplementary brief when he comes to question him, and of course the same applies to my learned friend Mr. Mann if he wishes to ask Mr. Freeman any questions.

MR. MANN: Do I understand there is a third brief which you propose to put in?

THE CHAIRMAN: There is, if you regard the summary as one brief.

MR. MANN: There are two in now.

MR. GRAY: My learned friend may comfort himself; he has seen all the material that we have. I hope that those who are interested or concerned have seen all that material. If they have not, they may have copies of these three documents. One is a printed summary, on white paper. The main submission is this grey covered pamphlet, and the reply to the stock insurers and income tax association is contained in this buff-coloured pamphlet marked "supplementary".

It seemed to me, Mr. Chairman, that you might like me to say a word to distinguish this part of the inquiry in relation to insurance from the general subject of cooperatives, with which so much of the time of this Commission has heretofore been occupied. My purpose is to suggest, and I hope to convince, that insurance must in this respect be regarded as an independent subject matter; and that very little of what has been offered in evidence and argument regarding cooperatives generally has any place in the consideration of this business of insurance with which we are now concerned.

I base that shortly on these two points that impress me at any rate. The statute itself, the Income War Tax Act, with which we are concerned deals, in paragraph 4(g) with the exemption of the factory mutual insurance companies and others,





and indeed all those with which we are concerned in this insurance inquiry. But section 4(p) is the paragraph of the statute which particularly relates to other types of cooperative organizations and which has occupied the major part of the time of the Commission. So on the first point we are now in a different compartment of that statute when we deal only with insurance.

THE CHAIRMAN: Except in so far as mutuability applies to both.

MR. GRAY: Yes, Mr. Chairman; precisely. Then it seems to me in dealing with merchandising cooperatives, whether they be producers or consumers, whether they be manufacturing or distributors, you are dealing with a form and type of business which is distinct from the insurance business, and distinguished from it by the fact, or at least by this fact, that the essential matters of the bargain to be made between the members or with their customers are known. They concern physical commodities, to begin with, whose costs and charges have already been ascertained or are capable of ascertainment during the accounting period with which the tax collector is concerned. The operation of the merchandising cooperative lends itself, therefore, to a different method of operation and approach, tax-wise, as well as in the practical operation of the matter.

Furthermore, the very fact that you are dealing with a physical commodity, whereas in relation to insurance you are dealing with a service which has no commodity character, distinguishes the two. But this perhaps is the paramount consideration; that in the insurance business you are dealing almost entirely with estimates for any period of taxation with which you are concerned. Insurance is continuous. You are to take an annual period. You are to determine, if possible,



the gain or loss in that period in so far as the taxing officer is concerned; and to do that he has no completed transactions, or very few, to which to refer. His estimate of gross income is an estimate having to do with so-called premiums earned, as distinguished from premiums written. His losses are unsettled and unpaid at the end of the year, and his reserves, so essentially part of this business, as distinct from the merchandising business, in character and extent are merely estimates. So I ask the commission, with respect, when approaching this insurance problem, to believe that you are moving into a different field which, in relation to income tax and excess profits tax, must now be examined without reference to much of the evidence and much of the argument that has been submitted in relation to cooperatives generally.

Now a word about the groups who are here. My learned friend Mr. Parker's arrangement of the order of these presentations suggests to me an element of logic in it on which I wish to make a short comment, in order that you will see how we relate to one another individually. He has put us in this order: the reciprocal insurance exchanges; the factory mutuals; the American mutual alliance, and the Ontario cash mutuals. If our friends the farmers' mutuals were here in the group I suggest that they would come in, in carrying out this element of logic to which I refer, between the reciprocals, who have just finished, and ourselves, who are just about to begin. I would say that for this reason ---

MR. PARKER: You might even put them ahead of the reciprocals.

MR. GRAY: Perhaps. The distinguishing features of these five groups are something like this. The reciprocals' principal characteristic is the unincorporated character of their grouping, and a great deal in their method of operation





is determined -- very much, for the tax gatherer -- by that element of unincorporated grouping. I am trying to avoid the use of the word "association." Indeed, they so impressed my friends, the Joint Stock Insurers that it seemed to me that they had already conceded the case in the brief they filed.

THE CHAIRMAN: Call it an enterprise, if you like.

MR. GRAY: That is an excellent term. This enterprise, then, stands by itself as an unincorporated enterprise, with its own special problems for the tax collector, with which we other members of the group are not concerned, we incorporated bodies or companies carrying on as such.

Apart from that, the reciprocals are our keen competitors, speaking for the factory mutuals. They are just as much our competitors as are my friends the Joint Stock Insurers, who sit behind me. The competition is just as keen. So we have no common interest when it comes to securing or dealing with a risk in which we are all interested. Then the factory mutual companies are like the reciprocals in so far as they have a deposit premium system; and the special character of this deposit premium system, as you already know, is recognized in the statute. Under the Special War Revenue Act the section which deals with reciprocals and the factory mutuals describes them as deposit premium companies. So that is a distinguishing feature of these two of the mutual group.

But I think I gathered from the evidence of the last witness that in the case of the reciprocals the deposit premium is more nearly related to the stock company rates than that of the factory mutuals, with which we are concerned; because in the factory mutual system there is no reliance whatever upon joint stock company rate-making procedure. Our deposit premiums are determined according to the experience of the group.





unrelated in any way to any joint stock company rating bureau or system; and furthermore it is a continuing feature of the factory mutual system that the amount or rate of deposit premium is not less in the average than ten times the amount of the probable or expected cost.

THE CHAIRMAN: And you find another point of contact in the four per cent premium tax, do you not?

Mr. GRAY: Yes.

THE CHAIRMAN: You and the reciprocals are the only ones in that class?

MR. GRAY: Quite right. And in that connection may I say at once that I think the last witness overlooked an important point there which affects us both, because in presenting his views of the effect of the Special War Revenue Act, section 13(f), where the rate of four per cent is imposed upon exchanges and upon factory mutuals, he omitted to call attention of the Commission to the fact that in addition to paying that four per cent upon the net cost or premium to the member, there is added an element of interest or investment income on the premium.

MR. PARKER: No; he included that in his statement.

MR. GRAY: Then it was my fault, because I missed it.

MR. HAYDEN: He added something for that.

MR. GRAY: In the part of his evidence I heard he omit to call attention to the fact that investment income is added to the net cost of the insured, in order to get the taxable premium.

Our friends who come with the American Mutual Alliance are to be distinguished from the factory mutuals principally in that the deposit premium does not bear the same relation to net cost which the factory mutuals does. For example, they might have dividends of some, shall we say, 15 to 30



per cent, participating dividends; but they are hardly in the class of the 10 per cent factory mutuals. The significance of that is this, that the investment income element of the factory mutual operation is much more important to the member and to the company than it is in the case of the ordinary mutuals represented by our friends the American Mutual Alliance.

THE CHAIRMAN: Or in the case of the reciprocal?

MR. GRAY: Yes; I think the same is true there. That is, an element of investment income is a substantial and important part of the gross income of the company.

Finally we come to the case of the Ontario cash mutuals, where we find a distinguishing element in that only part of their business is written on the purely mutual plan; but beyond this, they have also a system of fixed premium insurance carried on which, even though it be still insurance at cost, distinguishes it somewhat from the deposit premium method.

I thought you ought to see us in perspective in that way, in order that we may distinguish the factory mutual case on some important points from any of the others who are with us. Mind you, we are not competitors of the farm mutuals. We are competitors of the reciprocals. We are in some cases competitors of the American Mutual Alliance companies. We are not competitors of the Ontario cash mutuals, because we occupy different fields. The field of the factory mutual, as you already know, is limited almost exclusively to industrial and commercial risks, all of them sprinkler-protected, and so is highly selective.

Another point I would like to make just now, is that in addition to those who are here, and to whom I have just spoken, it seems to me singular that there are some who are not here, namely the mutual life insurance companies. I want to refer to them for a moment for one reason particularly. We say in





our statement that the factory mutuals ought to be treated precisely as mutual life insurance companies are treated when it comes both to the premium tax and to any consideration of income tax or excess profits tax.

I do not mean, for example, that the rate of taxation on life insurance need be the same as on fire. Not at all. It is quite likely that any minister would distinguish in the rate of premium tax that he would recommend to parliament in relation to life insurance and fire insurance. But the principle of the two is and ought to be the same, namely, that the net cost to the insured should be the taxable premium in fire insurance, as it is in life.

Furthermore we say that in relation to these elements of profit, the position of the Mutual Life Insurance Company and that of the factory mutual are identical, in that neither one, by its operations, produces a taxable profit, and therefore, when the tax collector or the statute has to be considered, the principle of the two is identical.

Let me just make that very clear as far as the factory mutuals are concerned. We are not here to ask for exemption of one dollar or any other denomination for the factory mutual fire insurance companies from any system of taxation which is to apply generally and without discrimination to the insurance business. If the tax collector can find in the factory mutual system a profit as that word is to be understood, or within the intention of the act, by all means let us have it assessed.

MR. PARKER: That is, you do not ask for any statutory exemption?

MR. GRAY: No, I do not say that at all. That is a different point, and I will come to that in just a moment. It is a very good point, and I thank you for the suggestion.

THE CHAIRMAN: Then section 4(g) is a comfort to you,





but you do not actually need it?

MR. GRAY: Precisely. To answer my learned friend right away, section 4(g) prevents litigation. It is no doubt well known to this Commission, as it certainly is to my learned friend Mr. Parker and those who sit behind me, that our friends the joint stock insurers did their best -- and that is quite a lot; they are good people -- to endeavour to persuade this government that a case ought to be stated under the Income War Tax Act as it stands at present, to have it declared that mutual companies develop a taxable profit which the tax gatherer was negligent in not having already assessed and collected. They were not able to arrange that project to their satisfaction, because they could not find a status for themselves in that form of litigation. But they still pretend, and in their brief they say, that if this act were properly understood the factory mutuals and all the rest of us would be paying income tax.

That is a question of law, and I expect that it will not be determined here by this commission. The value of that section 4(g) is this; that even though we are, as I respectfully submit, exempt at common law from income tax as such, by well understood and recognized decisions of the courts, the value of 4(g) is that it writes it out in plain terms, where all can read, and in a form which binds the courts as well as the tax collector. That is the value of 4(g); and I am not suggesting that it ought to be dropped. Indeed, we would urge most earnestly that it be maintained.

Just to complete the answer to my learned friend Mr. Parker, the main point I was making was this. The factory mutuals are not here to ask for exemptions or special privileges. They have never asked for any yet, and they seek none from this Commission. If there can be found in



our accounts or activities a form of profit subject to tax, of the quality which answers to that tax in the activities of our friends the joint stock insurers, who sit behind me, then let us have it taxed and we will pay the shot gladly, because these factory mutuals are only servants of the people, as are our other friends. They have no wish to avoid any form of taxation in circumstances and conditions such as these particularly, which is properly assessable against them. Indeed, we wish to go this much further and say, recognizing the need for income for the public revenues by way of taxation, that we think there is quite good room for saying that the insurance business may not be contributing all that may be expected from that business; and by "business" I am talking about the people who pay the shot, that is all policyholders. If this business is not now paying its full share of the burden of taxation which must be paid into the public treasury, then let us take the premium tax, which is of even application over all systems of insurance and all forms of organization; and, having put that on a non-discriminating basis -- that is, an even rate for all -- let us find the additional revenue in a premium tax which will bear evenly upon all forms and types of insurance.

The reason I consider that life insurance matter very important is this. How does it happen that we are here to-day and the Mutual Life Insurance people are not here? Well, my friend Mr. Parker tells me, "You came yourselves; you are volunteers." But he is kind enough to add, "If you had not come I would have sent for you."

MR. PARKER: I intimated that might be possible.

MR. GRAY: I mean to say he might have recommended that to this Commission.

THE CHAIRMAN: The method of procedure is of no importance,





MR. GRAY: No; Let nothing I say indicate that we were reluctant to come. Quite the contrary. We want to be here, because we have a story to tell. But we think that if there is any case against us, it is equally a case against the Mutual Life Insurance companies, because we cannot find -- and in our respectful submission the Commission will not find -- a distinction in principle between the method of operation of the Factory Mutual Fire Insurance Company and those of the Mutual Life insurers. That is particularly important in respect of one item of our accounts which becomes very important if one is to accept the emphasis put upon it by my friends the Joint Stock Insurers. That is the unabsorbed premium deposit. They have suggested in their briefs that this is an income of the same quality as the stockholders' dividend, earned from operations of the business; and they want it taxed in the same way as if it were a dividend to shareholder.

I think the position of the life insurance people is important, because I would like to hear them say the same thing to every holder of a participating life insurance policy throughout this country, from one end to the other. They have been very careful to say, "Oh, nothing we say applies to life insurance." You will find that in the Income Tax Payers' Association brief; you will find it in the Joint Stock companies' brief, and in the brief of the Canadian Chamber of Commerce. "Oh, no; we are not talking about life insurance premiums," they say; and then they turn right around and say, "Of course the fire insurance business is different. This is a profit comparable to that of stock company shareholders' profits."

Our respectful submission is that they are quite mistaken, and that the unabsorbed premium deposit of the factory mutual system is in principle and in fact of the quality of





the participating dividend of life insurance policies, only more easily identified as such.

THE CHAIRMAN: You would have to ask for an amendment of section 4(g), then, would you not?

MR. GRAY: Yes. That is precisely the point; the life insurance people are already there.

THE CHAIRMAN: You would have to ask for an amendment to include the life insurance companies?

MR. GRAY: No, I submit with respect, because section 4(g) says exactly the thing about the life insurance company which is not now in practice and effect applied to the factory mutuals. Section 4 deals with incomes not liable to tax. It says that the following incomes shall not be liable to tax herein, and then goes on:

"(g) the income of mutual corporations not having a capital represented by shares, no part of the income of which inures to the profit of any member thereof; and of life insurance companies except such amount as is credited to shareholders' account."

Those final words are necessary in the case of life insurance only because stock companies as well as mutuals have participating policies. Therefore those words are added to take care of the stock companies' participating policies; and if our friends behind me were doing participating business, as I wish they were and I hope they will, they should have the benefit of the same exemption. But apart from that the life insurance companies and the factory mutuals are in identical position under section 4(g).

Now I have just a word to say further about how we got here. The reason we are here, and the life insurance people are not, is principally this. In the Dominion Insurance reports for 1941 and 1942 the superintendent set out certain schedules



regarding income tax and excess profits tax in relation to the fire insurance business. There are no such tables about the life insurance business to be found in the report. In that report he said in some substance, after showing some figures with regard to tax exempt companies, among others the deposit premium mutuals, "Look at these deposit premium mutuals. Here are their premiums; here is their underwriting gain. That is all exempt from taxation, whereas down here the Joint Stock Insurers, presumably doing the same kind of business, have their premiums and their underwriting gain, and they are taxed," and he says to the world, "Isn't that terrible?"

That was quickly picked up by our friends the Joint Stock Insurers and their agency forces from one end of this country to the other; and you will find those figures reproduced in the briefs of my friends the Joint Stock Insurers. They are in the brief of the Joint Stock Insurance agents from Winnipeg, and I think they are in the brief of the Joint Stock Insurers of Halifax. They are referred to also in the brief of the Chamber of Commerce.

Out of this representation, I suggest, arose the public agitation which persuaded those who have responsibility for policy to make sure that their insurance came under the review of this Commission in connection with cooperatives, and I suggest that if it had not been for those figures we would not have been distinguished from the life insurance companies in Canada in this inquiry. Those figures, I am going to show, will be found inaccurate and misleading; a very important part of my brief is directed to making that point. At the moment I am emphasizing it so you will see how important it was to this whole inquiry, because I count that the circumstance that brought us here.

Now a word or two about the history of the factory mutuals.





These companies were licensed for the first time under Dominion authority in the year 1936, but they had been doing business in Canada for many years before that, probably from nearly about the time of Confederation. The company represented by my friend Mr. Freeman, as you know, has been in business in the United States since 1835. They had a substantial business, and I am saying "business" when I am talking about the factory mutuals, because I am not pretending that we are not in business. My friends need not spend any time belabouring the point that we are in business, because here we are, and say so.

We had a substantial amount of business in Canada prior to 1936, going back very nearly to the time of Confederation. Until 1936, however, in Canada it was unlicensed insurance; and you will not find any account of it in the Dominion Insurance Blue Book, so far as I know, because this not being licensed or registered, that is, the companies not being licensed or registered, they made no returns to that department prior to 1936.

That has been misunderstood by some people, notably by the Canadian Chamber of Commerce, who in their brief included an appendix against which I wish to warn the Commission. It was a statement as to the growth of mutual insurance in Canada from 1917 to 1944. In their figures for 1917 they showed the licensed business of Canada as representing the state of mutual insurance in 1917. Actually you will not find any factory mutual business in that at all, either in Ontario or in the Dominion, because it was unlicensed insurance in those days. The figures, therefore, are to be disregarded if the question of interest is how rapidly mutual insurance is growing in Canada. There was a large volume. Indeed, this is a significant thing, and I speak subject to correction





by my friend Mr. Hayden if he finds this not entirely true for his group. There was very little, and in fact I doubt if there was any -- I do not want to be too dogmatic about that -- foreign mutual fire insurance licensed in Canada in 1917 and before. Mind you, in the provincial departments there were very important fire mutual groups and local mutuals in Quebec and elsewhere licensed right back to before Confederation, but the business of the outside mutuals in Canada was principally, if not altogether, unlicensed prior to 1917.

Perhaps you would permit me just a word of explanation as to just why that is, because this ties into this business of these figures about the mutuals in the Dominion Insurance Report, and if it does nothing more it shows why we behave the way we do; why we react, as shall I say, rather violently to the suggestions of our competitors here that we ought to be restrained by some new legislative enterprise.

The situation is this. We were unlicensed because the Dominion Act was insistent that no company having its head office outside of Canada, that is no British nor foreign company, could come into Canada unless it could comply with statutory requirements which required it to deposit in Canada dollar for dollar securities equivalent to all liabilities undertaken within the Dominion. By virtue of that requirement, invented and intended, no doubt usefully, for the regulation of joint stock insurers, they excluded all of these important forms of competitors except local mutuals; that is to say Lloyds of London, the factory mutual group, the American mutuals, the reciprocals, all could not get licenses in Canada under the terms of those provisions, though they were very willing to do so. The reason was that the character of mutual insurance which is, our friends the reciprocals to the contrary notwithstanding, a common fund owned by all, was unable to divide the egg, shall I say,



in two, without breaking it. The mutual is one unit or body whose assets belong to every member. You cannot take the eight per cent of the Canadian Manufacturers Mutual members out of the Manufacturers Mutual group, and build a wall across the border line and say that these assets are for Canadian policyholders, without destroying the whole benefit of the security that Canadian policyholders have from the assets of the whole group. In other words it just could not be done; it was a contradiction in terms.

So all those years these important competitors stood outside the range on the Dominion government authority to do business in Canada. The legislation of 1910, referred to by my learned friend Mr. Mason, protected their position and said, "That is all right. Although we cannot licence you, we do not intend to exclude you. Go ahead and carry on your business here." There was provision made there for unlicensed or unregistered insurance, under the 1910 act, which permitted these companies to carry on their business, under a certain handicap but enabled them to get on somehow or other without violating the law.

In 1917, however, after they had been over to the judicial committee to decide whether or not brokers in Montreal for London Lloyds had a right to solicit insurance in Montreal, and they came back with a judgment in which my learned friend Mr. Geoffrion participated most effectively, which decided that the Dominion Insurance Legislation was ultra vires of parliament and that these prohibitions could not be imposed upon representatives in Canada of London Lloyds and others -- then the Act was reconstructed in 1917. What was done was an effort to replace everything they had before in a different form, and by a different constitutional method. So an appeal was made to the Criminal Code, and we had that





special section of the Criminal Code enacted in 1917. Under "Immigration" we had section 12 of the Insurance Act prohibiting any insurance company from emigrating into Canada. Then we had section 11, which said that no agent could carry on business in Canada unless he did this and that; and they put back into the code every bally thing that had created the trouble in 1916.

Then again we had to struggle for existence, because the provisions of the Criminal Code were much more serious than the old provisions of the 1910 Act regarding unlicensed insurance. They made it possible to put any man who came over here from the Providence or Boston office of the Manufacturers Mutual, or any broker representing London Lloyds, in jail for an offence under that Act if he dared to collect a premium or ask a man to accept insurance in any of these highly reputable organizations.

So it was not until 1923 that any relief was found. That is when, as Mr. Mason told you, the reciprocals won their freedom; and when they did that they brought down the structure again and all mutuals had the benefit of that constitutional victory.

In 1931, however, we had to meet another attack by way of taxation. Then the Dominion, not content with the obstacles already put in the way of the mutuals, indicated that there should be a special tax imposed upon all the members of these companies, or the subscribers to reciprocals, who dared go outside the list of licensed companies for the benefit of a competitive rate or service. It was in 1931 that the factory mutuals, who were parties to that proceeding, again with the assistance of my learned friend Mr. Geoffrion, won their freedom from discriminating taxes under the Special War Revenue Act, directed against unlicensed insurance.





So we come to 1934, when the whole insurance legislative structure, having been undermined by the constitutional question, new legislation was drafted by the government with the specific purpose of giving a right of way to the factory mutual companies, to the reputable reciprocals, and to a certain limited group of insurers against whose responsibility no shadow of charge of insecurity could be laid. Even yet they would not let in Lloyds of London, and to this day Lloyds of London are not licensed in Canada under the British and Foreign Insurance Companies Act.

In letting the factory mutuals into the licensed group in Canada for the first time in the legislation of 1934 and 1936, though, I think it right to say all that was passed over the most stubborn opposition of the Dominion superintendent of insurance, which carried him down to the Banking and Commerce committee of the Senate to oppose it with all the force and influence he could bring to bear.

Again an attack was made from the legal angle on the mutual position in 1942. As lately as that year --

THE CHAIRMAN: Are you sure of that, that it was the present superintendent of insurance who opposed that?

MR. GRAY: I was there, Mr. Chairman. Mr. Meighen was in charge of the bill for the government in the Senate. The late Mr. N.W. Rowell, later Chief Justice of Ontario, drafted the legislation on the instructions of the Prime Minister, Mr. Bennett; and he had, in consultation with all the interested parties, worked out a plan of legislation which was acceptable to all the parties except the Dominion superintendent of insurance and our friends the Joint Stock Insurers. When that legislation came to the Banking and Commerce committee of the Senate Mr. Rowell and Mr. Meighen had there to meet the opposition of the present superintendent



of insurance, who assured the committee that the whole plan was a mistake and misconceived, and ought not to be adopted. Nevertheless it was enacted.

In all those proceedings, every one of them, we have had to face the associated opposition of our friends the Joint Stock Insurers, who were there by counsel to oppose our coming into Canada under any Dominion government licence. Always they were associated in interest with the Dominion government, which was maintaining its claim to insurance jurisdiction under the existing statutes. So to-day we find this situation confronting us again, in a new area, that of taxation before this Commission. I hope you will not think we can dissociate ourselves, whatever the Commission can do, from the long struggle that these companies have had to obtain any recognition under Dominion statutory provision for the form of insurance which they represent.

Now may I turn to the point regarding the Special War Revenue Act and the rates of taxation imposed on insurance premiums, on the factory mutuals as premium deposit companies, in distinction from the joint stock insurers.

THE CHAIRMAN: We usually adjourn at 4.30, Mr. Gray. Do you think it would be well for you to bring in that point now, or shall we go on in the morning?

MR. GRAY: If it suits the Commission I should like it very much if you would call it 4.30.

THE CHAIRMAN: Very good. I think that would be better.

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The Commission adjourned at 4.30, to meet to-morrow, Tuesday, April 17, 1945, at 10 a.m.

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*Canada - Co-Operatives, Royal Commission*

ROYAL COMMISSION  
ON  
CO-OPERATIVES

1945

PROCEEDINGS

(OFFICIAL REPORT)

VOLUME No. XIX

PLACE Ottawa

DATE April 17, 1945

PAGES 5728 - 5901



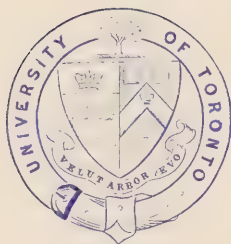
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ROYAL COMMISSION ON CO-OPERATIVES

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Ottawa, Tuesday, April 17, 1945.

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ROYAL COMMISSION ON CO-OPERATIVES

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The Commission appointed to inquire into the present position of Co-operatives in the matter of income and excess profits tax, organization and business methods and operations, and the comparative position of persons engaged in business directly competitive therewith, met in Ottawa, on Tuesday, April 17, 1945.

PRESENT:

The Hon. Mr. Justice ERROL M. McDOUGALL, Chairman.

B. N. ARNASON	}	Commissioners.
G. A. ELLIOTT		
J. M. NADEAU		
J. J. VAUGHAN		

Eugene T. Parker, K.C.	}	Associate Counsel.
Roger Brossard, K.C.		

Major H. D. Woods	}	Associate Registrars.
J. A. Chapdelaine		

Colonel G. W. Ross	}	Executive Secretary.
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APPEARANCES:

W. B. Francis,	Group of Co-operative Associations	
W. H. Howard, K.C.,	Private Grain Interests	
W. P. Fillmore, K.C.,	Private Grain Interests	
R. H. Milliken, K.C.,	Saskatchewan Co-operatives	
G. W. Mason, K.C.,	American Reciprocal Association	
V. Evan Gray, K.C.,	Factory Mutual Fire Insurance Companies	
Hon. S. A. Hayden, K.C.,	American Mutual Alliance	
N. S. Robertson,	Ontario Cash Mutuals	
Russell MacKenzie, K.C.,	Canadian Board of Marine Underwriters	
J. A. Mann, K.C.	}	Joint Stock Companies
Aime Geoffrion, K.C.		
A. Leslie Ham		

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Ottawa,  
Tuesday,  
April 17, 1945.

The Commission met at 10 a.m., Mr. Justice McDougall presiding.

MR. GRAY: Mr. Chairman and gentlemen, I said at the adjournment last evening that I wished to mention the Special War Revenue Act. In this connection may I read one paragraph from the main submission, which is the gray covered pamphlet, beginning at the bottom of page 2:

"An example of such unfairly discriminatory taxation appears in the special war revenue legislation of 1931 (21-22 Geo. V. Cap. 34 s. 16 (1) (a)), which was declared ultra vires by the Judicial Committee of the Privy Council before it came into effect. (1932 A.C. 41) If that legislation had been maintained and applied, every Canadian member of a factory mutual insurer would have been compelled to pay an annual tax of 15 per cent of gross premium deposits in addition to the 1 per cent premium tax paid by the company. This additional tax was at that time approximately three times the total annual expenditure for losses and expenses in the system."

May I say in explanation of that, that in 1931 the absorbed part of the premium was on the average, I think, only 5 per cent of the total deposit. I continue to read: "Obviously such legislation would have compelled the factory mutual companies to abandon the provincial licences to carry on business in Quebec and Ontario which they then enjoyed and to withdraw from business in Canada. It seems that in that case, at least, the courts were a better protector of the public interest than was parliament itself. There is, therefore, a responsibility on this Commission to make



recommendations of methods of taxation of this insurance business, which will be appropriate to the organization to which it is to be applied, and will thus be discriminatory, but not unfairly discriminatory in its application."

I feel that I owe the Commission an explanation of that sentence. "It seems that in that case, at least, the courts were a better protector of the public interest than was parliament itself." I would not want the Commission to think that parliament was expressing, in that legislation, its judgment on the merits of that tax, or the desirability of having factory mutual insurance service in Canada; and I wish to suggest that parliament was quite unaware of the effect of that legislation when it was enacted. At that very moment my learned friend Mr. Geoffrion and I were in London, preparing to argue the constitutional question on the Quebec insurance reference. My learned friend Mr. Geoffrion was appearing for the province of Quebec, and I was appearing for the factory mutual companies. We heard of this legislation only by telegraph, when it was introduced in the minister's budget resolutions. On my return, careful search was made of the records of both houses and, according to my present recollection, on which I think I can confidently rely, there was not a word of explanation given in either house as to the effect of that innocent-looking bill, which seemed to provide only for a tax of 15 per cent on premiums in unlicensed insurance. So I suggest that this Commission ought to --

THE CHAIRMAN: But very often the courts have these innocent-looking statutes to deal with.

MR. GRAY: Yes, I think that is true. Fortunately the Judicial Committee declared this one to be ultra vires, and therefore it was invalid. But in considering the merits of





taxation of the factory mutual companies I would like this Commission to think that parliament has not, by this legislation, expressed an opinion in relation to that tax.

You will observe also, in that connection, that the factory mutual companies had licences in the provinces of Ontario and Quebec before they were licensed in the Dominion of Canada, the latter occurring only in 1936. The provinces had given licences to these organizations in 1927, and I should like to make this point: that throughout this whole matter it will be found that provincial legislatures and provincial governments have nourished and protected mutual insurance organizations of all types, whereas the policy of the dominion legislation, in so far as it can be found in the statutes, has offered no similar encouragement or protection to mutual insurance as such.

I suggest that the reason for that is that the provinces have learned much from the experience with the local farmers' mutuals through Canada, which in nearly every province, and particularly in the provinces of Quebec, Ontario and Saskatchewan, have done a magnificent piece of public service over many, many years. So, having seen in operation, with full security to the public, a system of mutual insurance which was independent of stock company insurance in those provinces, I suggest they protected and encouraged these institutions as competitors for joint stock companies, whereas in the dominion legislation you will find that the whole form of the insurance statutes has been moulded by the character and mode of operation of the joint stock companies, to the practical exclusion of mutual insurance of all types.

I said I would show that the representation in the Dominion Insurance Blue Book relating to underwriting profit





of the factory mutual companies was inaccurate and misleading; and that I believe the Commission will think one of the vital and important points raised by this inquiry because, as I have already said, out of the publication of those figures has come the demand for the inquiry by this Commission into the fire insurance business of mutual companies. Therefore I ask leave to read a section from the main brief, beginning on page 14, entitled, "Underwriting Account in Canada." This is the only section of this brief which I will ask your indulgence in reading. Because this section refers to exhibits found at the back of the book, to which it may be inconvenient to refer, may I give you copies of the exhibits to put alongside the page on which you are reading, so if you wish you may follow the significance of the statement.

"The annual statement form required by the Dominion Department of Insurance --"

Here is a specimen blank copy of the statement form referred to.

"-- from all British and foreign companies, in the account entitled 'Underwriting Account in Canada,' misrepresents the Canadian business of the factory mutual companies. It purports to show the Canadian business of the factory mutual companies as a separate compartment of their undertaking, and thus to ascertain the result of the Canadian operations: a method which is quite impracticable and incorrect. This, of course, is well understood by the examining officials of the Dominion Department of Insurance, but unfortunately, the reproduction of the figures presented by these annual statements in the published Blue Book of the department has led to considerable public misunderstanding of the operations of



the premium-deposit mutual companies. The balance of the account on page 14 of the annual statement has been carried into the Blue Book in an aggregate described as 'Underwriting Profit' 'Deposit-premium Mutuals,' in the special schedule in the 1942 Blue Book at page LXVII and following pages, as 'Non-taxable Underwriting Profit.' Both of these representations are incorrect and misleading as to deposit-premium companies. No criticism of the exhibit is intended in its application to fixed premium fire insurance companies; it simply is not appropriate for the factory mutual system.

"Exhibits I and II, set out in appendix 'B' compare and contrast the actual results with the figures in the table on page 14 of the annual statement of the Manufacturers Mutual Fire Insurance Company (one of the factory mutual group) in respect of business for the calendar year ended December 31, 1941. Exhibit I is a copy of that statement. It will be noted that the words 'underwriting gain' and 'underwriting loss' as printed in the exhibit have been struck out by the company when filling in the return, and this is the uniform practice of the factory mutual companies when completing this return. This deletion is intended to call attention of the department examiners to the fact that the exhibit does not result in ascertainment of what is generally regarded as underwriting gain or underwriting loss. Those who prepare the Blue Book have ignored this reminder.

"Exhibit II is a showing for the same company for the same period, on the same facts, of the operating surplus of the company, both with and without investment income taken into the account. The underlying principle of Exhibit II is that Canadian members assume liability for and pay that





proportion of the total losses and running expenses of the company which the total of Canadian premium deposits in force on December 31st, 1941, bears to the total of all premium deposits in force in the company on that date. This is the most practical representation of what actually happens in the company's operations over a period of twelve months.

"If an accountant wished to know what happened to the reserve of a factory mutual company during any period of operation, this Exhibit II will show as nearly as possible what was added to or deducted from (as the case may be) the reserves of the company, by reason of the operations of the period. Exhibit I certainly would not give any reliable information on this point. In using 8 per cent of totals, the actual proportions in this company of Canadian to total premium deposits is applied. In another company the proportion would be different. In the aggregate of the system, the proportion is, as heretofore stated, about 7 per cent instead of 8 per cent.

"Exhibit II includes investment losses or gains and the unabsorbed premium deposit, on a proportional basis; the expenses and losses incurred include the same proportion of all expenses and losses of the company wherever the same are incurred. A comparison of the corresponding figures in the two exhibits shows every item irreconcilable with its counterpart. One can see at once how wide a discrepancy exists between the resulting debit of \$23,293 for the underwriting account, excluding investment income, under Exhibit II and the credit balance of \$106,977.58 under Exhibit I. It is the latter figure which is carried into the totals for premium deposit companies in the tables on page XLVII of the 1942 Blue Book. From this the importance of the point we have to





make may be gauged in relation to the whole exhibit in the Blue Book."

Now I ask you to be good enough to turn to page 33 of the same brief, and let me continue to read on that page:

"First, it is necessary to examine the item called 'reserve for unearned premiums at beginning of year (80 per cent reserve).' For a fixed premium fire insurance company this item is a conventional formula for the estimate of the sum necessary to reinsure all unexpired risks of the company in some other insurer as of the date referred to in the item. Its adequacy depends on the premium rate level maintained by the company, so that even among stock companies it is only accurate if the company maintains bureau-tariff rates of premium. It is more truly a pro-rata estimate of the unearned portion of the total premiums on all unexpired policies at the date referred to, assuming for the purpose of this computation that the business expires at a uniform rate over the twelve months period. Accordingly, as a quick method, this item is calculated at 50 per cent of the written premiums in the policies in force at the date referred to. Then a 20 per cent reduction from this total figure is made to represent an acquisition cost allowance to the original company upon the reinsurance of its business as a going concern. This gives the 80 per cent figure referred to in the printed statement. A similar computation of the liability for unearned premiums at the end of the year is set off on the debit side of the account and the difference between these two items represents the increase or the decrease in the liability of the company for such reinsurance reserves.

"Now as stated above, no complaint is made against this formula for fixed-premium insurance companies. Assume, for



example, that a risk is insured for one million dollars in a joint stock company at a flat premium of \$600, and that this risk has not expired on the 31st of December. The reserve for unearned premiums at the end of the year will include 80 per cent of 50 per cent of \$600, i.e. \$240, for this particular policy, regardless of its date of expiry."

You will see that this is visually interpreted on this diagram, which is the other exhibit.

"But consider the case of a similar risk insured for one million dollars in a factory mutual company on a premium-deposit basis, and a striking difference appears. The premium-deposit in this case is 60 cents per \$100 of insurance, which makes a premium deposit of \$6,000 instead of a flat premium of \$600. At the end of the year 90 per cent of this premium deposit is returned or credited to the factory mutual member, leaving the absorbed portion of the premium \$600 and the unabsorbed portion \$5,400. Computing the reinsurance reserve in accordance with the formula required by the department statement form on page 14, we find that this risk contributes to the aggregate reserve 80 per cent of 50 per cent of \$6,000, which is \$2,400 as against the corresponding figure of \$240 in the case of the joint stock company. Accordingly, identical risks (which we are bound to assume can be re-insured at the same cost in some other insurer) produces a liability in the annual statement of \$2,400 for the factory mutual company and \$240 for the joint stock company, notwithstanding the fact that for the purposes of this illustration, the net cost to the insured is the same in both cases, namely, \$600 for one year. The effect of the statement form is to inflate the liability of the factory mutual insurer for re-insurance reserve in this account to 1000 per cent, as





compared with the joint stock companies on the same risk, and the inflation is necessarily carried into the balance in the statement. The diagram which follows Exhibits I and II in this appendix gives a visual demonstration of the foregoing explanation.

"Of course, in actual practice, the true net cost to the insured of insurance of similar risks in the factory mutual companies is substantially less than in joint stock companies, but that question and argument seems irrelevant to the enquiry of this Commission and is therefore not developed to demonstration. The point which it is desired to make very clear and irrefutable is that no conclusion as to the underwriting gain or loss can be founded upon the exhibit in the annual statement of factory mutual companies at page 14 of the annual statement form.

"Take next the items of 'Claims Incurred,' and 'Expense (including adjustment expenses) Incurred in Canada': under the Department of Insurance form, Exhibit I only the losses and expenses actually disbursed in Canada are included in this item; but these items bear no relation whatever to the losses actually charged to Canadian members and represent only a fraction of the expenses chargeable and actually charged to the Canadian members. The company losses and expenses for the Canadian business include a proportionate part of the losses and the whole operating expense of the company in the United States as well as in Canada, as, of course, both the legal and the practical application of the mutual method requires. In the two exhibits set forth above, we have, therefore, the comparative figures of \$32,970.01 in the department statement and \$82,614 in the company account for the same item of expenses, and comparative figures of





\$148,024.29 in the department statement, and \$99,195 in the company account for losses. Taking these comparative exhibits, we see then that what the dominion department has included in its Blue Book figure as an 'underwriting gain' of \$106,977.58 for the year 1941, is in actual fact an operating deficit of \$23,293.

"It is also clear from the above analysis that in actual fact such an underwriting statement as Exhibit II will always show a deficit in the factory mutual operations when the investment income of the company is excluded from the account, as the Dominion Insurance Department requires. Therefore, it never could produce an underwriting profit, taxable or non-taxable."

That last paragraph, I think, is a mistake; because in some of the years since this was written, and with different figures I have discovered cases in which there is a surplus. So I think we ought to strike out that last paragraph on page 35 completely. I ask you to do so.

THE CHAIRMAN: The whole paragraph?

MR. GRAY: The whole of that paragraph, beginning, "It is also clear." Now may I go back to the bottom of page 15:

"Now the Dominion Blue Book has aggravated the misrepresentation involved in this exhibit of deposit premium company operations by carrying these figures into an exhibit in the Blue Book purporting to set forth the situation respecting income and excess profits taxes paid or exempt under the present law at pages LXIX and following. Not only has the balance of the inaccurate statement form been carried forward in the aggregate as an underwriting gain or profit, but these same aggregate figures have been exhibited at



page LXXII of the Blue Book as 'Non-taxable Underwriting Profit.' The plain fact of the matter is that if the true figures are used and rules are applied to factory mutual companies similar to those now applied to British and foreign stock companies (that is to say, the exclusion of investment income from the underwriting account) no deposit premium mutual develops any underwriting gain or profit on its operations.

"Demonstration that the publication of these figures in the Dominion Blue Book has actually misled the public and is in part responsible for the extension of the work of this Commission to the fire insurance business is seen in the leading article published in 'The Canadian Underwriter' of Toronto for June 15th, 1944, under the title 'Incidence of Taxes upon Different Classes of Insurers: Disparity of Treatment is Revealed by Dominion Superintendent of Insurance in his Report Covering the Business of 1942.' Included in this article, which exhibits the figures above referred to as 'non-taxable underwriting profit' appear the following statements:"

I will not trouble to read all of that quotation.

MR. MANN: With your permission, Mr. Chairman, I should like to draw Mr. Gray's attention to the fact that the Canadian Underwriter, to which he refers, is in no way, or in any manner, shape or form, associated with the Canadian Underwriters Association. If that impression got to the Commission, I wanted to dispel it immediately.

MR. GRAY: My learned friend Mr. Mann is quite right, and I thank him for that reminder. I have here a photostatic copy of the article in question. Although the publication is called the Canadian Underwriter, it is an independent insurance magazine. But it has a wide circulation throughout





Canada among stock company insurance agents. And it will be found that these are the same figures that are used in the brief of my learned friend, and in the briefs filed with this Commission by stock company agents in Halifax and Winnipeg. The figures are on page 17, and I wish to give you the correct figures which I say should be substituted for those on that page. Under the heading "Premiums" we say the correct figure is \$2,107,271. Under "Underwriting Profit" the correct figure is \$218,745, remembering of course our objection to the title "Underwriting Profit." When I wrote this brief I had only the 1941 figures, and they were responsible for that sentence which I have struck out, that sentence reading, "We can be certain that the correct figure, produced by the method applied in Exhibit II, would be a minus quantity." It is a minus quantity in 1941 and in 1943. The figure for 1942 is extraordinary, however, and it developed a positive figure of \$218,745.

MR. VAUGHAN: In that last column, "Profit After Taxes," is there any change?

MR. GRAY: Yes. That figure of \$633,232 should be struck out and nothing inserted there at all, because there is no figure comparable from the joint stock companies with our profit after taxes, since they never include investment income in their exhibit of so-called underwriting profit. Therefore if I were to attempt to put any figure in the right-hand column it would be misleading as a comparison, so I ask you to please note that we object to the figure in that column, \$633,232, as being incorrect, and we do not offer any substitute for it at this place.

On the same page, 17, there is a reference to a speech made by my learned friend Mr. Leslie Ham, which I should like





to say was not intended as a reference to any of the counsel engaged in this inquiry. At the time it was written Mr. Ham was and I think still is manager of the Canadian Underwriters Association, and it is only in that capacity I had reference to him in this brief.

Then I have only one more point to make and I will sit down and make way for the witness. That concerns the matter of the Special War Revenue Act, and our complaint of discrimination as between the factory mutuals and stock companies. I ask leave to read one paragraph.

THE CHAIRMAN: In the year 1942 how did you carry the item of \$218,745 in your statement? A. It never appeared in any statement filed with the dominion government.

THE CHAIRMAN: Or in any other statements that were published. How was it carried?

MR. GRAY: Just as you see it in Exhibit II. Let us look for it there.

THE CHAIRMAN: That is for 1941. Apparently 1942 was the only occasion on which you say there was such a figure?

MR. GRAY: No, not the only one. I say only this, that 1942 was a very extraordinary year and produced an extraordinary credit balance.

THE CHAIRMAN: How did you entitle this sum of \$218,745 in your statement, though not necessarily your statement to the insurance department?

MR. GRAY: I think I understand the question --

THE CHAIRMAN: Was it not "underwriting profit"?

MR. GRAY: No, sir. Let me just look and see. I have here the statement and it is headed "Deficiency or Surplus." Where those words came from in this heading I am unable to say. I think those are my own words, "Deficiency and Surplus."



Let me ask Mr. Freeman if he can tell me. Let me say this. Until I asked for these figures the companies had never made up, as far as I know, a statement of their Canadian business distinct from their over-all, and they never had this figure in their own possession until I asked to compute it. Therefore it has never appeared, as far as I know, in any government return or any published financial statement, because they never did take off their Canadian business separate and apart from the over-all. Perhaps that is the only answer that could be made to that. At any rate, Mr. Freeman will be heard in a moment; if there is any further inquiry it can be pursued with him.

In this statement for 1942, which I have here for all the companies made up on the basis of Exhibit II and sent in at my request for the purposes of this inquiry, this item is shown about the middle of the page, as you will see, under the heading, "Deficiency or Surplus," and at the extreme right-hand is carried out a different figure entitled, "Total Underwriting and Investment Gain," or, "Total Underwriting and Investment Loss," as the case may be.

MR. PARKER: Is the gain a profit?

MR. GRAY: No, the gain is not a profit in the sense that we are discussing here. The gain is very plainly a surplus or a deficiency, as the case may be. It is the part which is either added to or subtracted from the reserves of the company at the end of the year. Let me make that plain. The balance which I have developed here under the heading, "Total Underwriting and Investment Gain," or, "Total Underwriting and Investment Loss," is the amount which is added to or subtracted from the reserves in the hands of the company at the end of the calendar year.





THE CHAIRMAN: And that column, I take it, shows a surplus every year?

MR. GRAY: No, not every year.

THE CHAIRMAN: In the majority of years?

MR. GRAY: I have the exact number. Thirty-one years show a gain and fourteen show a loss, in the forty-five shown.

Perhaps you would be interested also in this information, obtained as a result of this same exhibit. The total underwriting and investment gain for all eleven companies for the four years, 1940, 1941, 1942 and 1943, developed in this manner, according to our own figures and after this special inquiry, is \$489,399; and that is to be compared or contrasted with what the Dominion Government Blue Book figures develop for the same companies for the same years, the figure of \$1,917,268. So you see what we say is the true figure is something like 25 per cent of the figure for a four-year period developed by the Dominion Blue Book figures.

Now might I say that I am glad to observe the Commission has at its service expert accountants who could verify these figures, if that is desired; and we gladly offer to make available to them, or to anyone else whom the Commission wishes to see them, our accounts, without any reservation of any sort whatever.

MR. PARKER: I wonder if my learned friend would permit me to make an observation at this point in reference to the accountants. Personally I do not know anything about them. Would my learned friend care to state to the Commission in what way this entire question of the blue books is relevant to the inquiry of this Commission? Let us assume that the blue books are all wrong. Let us assume that to be so; does





it help the Commission?

THE CHAIRMAN: I think the argument is directed to the impression created throughout Canada as the result of the blue books.

MR. PARKER: But that does affect the point of whether or not they make profits.

MR. GRAY: And another point is this. Our competitors and critics have produced these figures in their case; that is the plaintiff's case, if I may say so. The plaintiff's case is based on these figures. They are in their briefs. Here is the brief of the joint stock companies; these figures are here as an exhibit. Here they are also in the briefs of the stock company agents from Winnipeg and Halifax. These are the only figures which the plaintiffs have produced.

MR. MANN: Are the agents also the plaintiffs?

MR. GRAY: Yes, I suppose so.

THE CHAIRMAN: I would certainly propose, as far as I am concerned, to ask Mr. Glassco to make a reconciliation of these figures.

MR. GRAY: He will be very welcome indeed to inquire into them. Our accounts will be gladly made available, without any reservation at all, to his inquiry. My friend Mr. Freeman suggests that by adding all the figures, as I have done, for the eleven companies, I have produced a result which really represents the business as if it were all carried on by one company for four years. Actually there are eleven companies, but the figures I have used, both for the dominion department and our own, add into one total and aggregate the figures of gain and loss for the eleven companies on all Canadian business. Mr. Freeman suggests that I say, as I gladly do, that it is a representation as though we had one company in



Canada carrying on Canadian business only, standing on its own feet, apart from the United States portion of the company's business. Then my learned friend Mr. Geoffrion asks me to explain the meaning of the item in Exhibit II under the heading "Less: Unabsorbed declared, \$435,101." That represents the return to the factory mutual member of the unused part of his premium deposit for that year; that is for all the Canadian members.

MR. NADEAU: Is it paid back or declared?

MR. GRAY: If the policy is terminated, it is paid back. If the policy is continued it is credited on his next year's account, and he is asked to make good his premium deposit to its original, proper amount.

MR. MANN: Does he implement the amount of his original deposit each year?

MR. GRAY: Most policies are written for five or three-year terms, as the case may be; and at the end of the policy term he implements the premium deposit, restoring it to its correct initial level.

MR. MANN: But not each year?

MR. GRAY: At the termination of the policy term. Regardless of the term, whether it is for one year, three years or five years, the premium deposit is the same in amount. I take this opportunity to remind you that these factory mutual companies deal with their members only. That is, they have no insurance on any risk other than their own members, or re-insurance of the members of another company in the same group of eleven.

MR. NADEAU: What are the requirements to become a member?

MR. GRAY: The nature of the risk is the most important requirement. It must comply with the minimum standards of the





factory mutuals for fire protection; that is to say, it must have complete or, if not complete, the main risk must be -- Mr. Freeman gives me something better than my extemporaneous efforts. Let me read from these requirements of membership, in this printed statement of the company. The requirements are:

"1. Slow-burning or fireproof construction for main buildings.

"2. Very high standards of neatness and order.

"3. Adequate protection by automatic sprinklers, fire hose, hand extinguishers, etc.

"4. Regular watchman service with watch clock while plant is not in regular operation.

"5. Fire barriers by masonry walls and fire doors between important divisions.

"6. Isolation of hazardous processes.

"7. Periodic regular inspections made of each individual risk by trained men of broad experience who are able to give competent advice concerning protection against loss, and compliance by the members with the requirements of these examiners."

THE CHAIRMAN: That is a rather restricted field?

MR. GRAY: Very.

THE CHAIRMAN: Who are your main competitors in that field; the reciprocals?

MR. GRAY: The reciprocals and the joint stock insurers. Some of our friends the mutuals, represented by Mr. Hayden, come into this field, but not all of them; and only, I think, in the case of specialized risks. As I think you have learned from the brief, the average Canadian risk is in the neighbourhood of \$1,000,000 for coverage, which in itself shows that it





is limited to industrial and commercial properties of very substantial physical value.

Now with one final point I will have finished.

MR. ARNASON: I suppose each company tends to specialize in a certain type of risk, depending upon the type of manufacturing activity carried on.

MR. GRAY: No, Mr. Commissioner. All eleven of these companies write the same classes of risk throughout, and you will see the importance of that when I say that their inspection and engineering service is a joint organization. It is conducted by a special organization of engineers whose head office is in Boston. It does the inspection and reporting work for all the eleven companies, at the expense of all companies combined. That is to say, the total expenditure for the year is apportioned among the eleven companies, but this is a common service in which professional engineers do the inspection and reports upon individual risks for all companies, and in many cases all companies will be interested in the same risk. For example, we have at least one risk in Canada of over \$200,000,000 in aggregate of insurance on that one risk. That, of course, is not carried exclusively by one company only; but that placing company retains a certain part of the \$200,000,000 and distributes the remainder among the other ten companies, or certain selected ones from among them.

This is the one important point I would like to make. The Canadian risks are integrated with the United States risks in the inspection and report service, so that the inspectors are specialists. Take for example pulp and paper, with its special problems of explosion and other hazards peculiar to the business. They are associated for inspection purposes with pulp and paper mills in the United States, of



a similar purpose. So also take an electric company. I do not want to mention any risk in particular, but supposing it is a company that manufactures dynamos and generators and heavy electrical equipment. It would be associated, for inspection purposes, with similar industries in the United States. That is one thing I want to keep in the mind of the Commissioners; that it would destroy the organization if we were compelled to do what the Dominion Superintendent of Insurance has long wished us to do; that is, divide our business on the boundary line between Canada and the United States. In our respectful submission that is impracticable and impossible.

Just one more point on that. You will notice that we in Canada, and I am speaking as a Canadian, are dependent on United States service in mutual insurance to a greater degree than any other. A British mutual cannot cross the Atlantic. That is not because it is allergic to water, but practically you cannot run a mutual company in Great Britain and Canada at the same time. So there are no British mutual fire companies licensed in Canada. We have to get the integration of our Canadian industrial risks with the United States plants of similar character across the border; and for that reason you will find that in these briefs I have submitted, where I have distinguished British companies from others with offices outside Canada, I do so because it is only in the group of British companies as reported in the dominion reports that we are able to get the joint stock companies exclusively by themselves. In all other groups, Canadian and foreign, you have an admixture of joint stock, mutual, reciprocal and other forms of insurers grouped together in one exhibit. Therefore to compare factory mutuals with stock companies,





I have had to look at the British figures in the insurance report.

Now I come to this point about the Special War Revenue Act, about which I asked leave to read a paragraph which is on page 13 of the brief. It is in connection with this matter of the taxation of investment income under the Special War Revenue Act, which we say discriminates as between the factory mutuals and the joint stock insurers. I want to read this paragraph, beginning in the middle of the page:

"The average premium rate for fire insurance in Canada for 1942 (as reported in the Dominion Insurance Blue Book at page X) is 66 cents for \$100 of insurance for one year. That is the average for all companies on all classes of risks. Taking the British companies, among which there are no mutuals or self-insurers, the same table shows an average fixed premium rate of 62 cents per \$100 of insurance taken in Canada. The average rate of premium deposit required for the factory mutual companies for 1942 was 58 cents for \$100 for insurance (protected manufacturing and mercantile risks only). Of this average premium deposit, the factory mutual companies give back to their policy holders after insurance for one year, an average of 90 per cent, which is about 52 cents. The net amount of the average mutual premium deposit absorbed by the company is, therefore, about six cents for \$100 of insurance. To add interest on 52 cents for a year to taxable net premiums --"

As the Dominion Act requires us to do.

"--increases the tax payable by about one-third. The stock company does not return to the policy holder any part of its initial premium; yet, the stock company is not required to add any item of interest on premium or premium reserves to its





taxable premiums. Neither should mutual companies be required to do so."

Then will you please look at the supplementary brief in the buff coloured binding, page 1:

"The factory mutuals acknowledge the concession of the joint-stock insurers, in paragraph (c) on page 11 of their brief, that the Special War Revenue Act, imposing a premium tax at the rate of 4 per cent on premium deposit mutual companies and 2 per cent on joint stock companies, is unfairly discriminatory, and that this inequity should be remedied by making uniform the rate of premium tax on all types of insurer.

"In their main submission, the factory mutuals have said that the equalization of the premium tax under the Special War Revenue Act would produce substantial additional revenue. (Page 28) Figures given us by the Dominion Superintendent of Insurance show the following amounts collected under Section 14, as tax on 1943 premiums:"

THE CHAIRMAN: Mr. Gray, do you consider that particular Act within our terms of reference?

MR. GRAY: Yes, Mr. Chairman, I do. Do you wish me to say why?

THE CHAIRMAN: Yes, I would like to know.

MR. GRAY: Shortly, there are two points. First, equality of taxation has been used as a sort of slogan. It is not our slogan; I am not adopting it.

THE CHAIRMAN: I so gathered from your brief.

MR. GRAY: No, I am not adopting it; but again, may I say the plaintiff's case is founded on inequality of taxation. The appeal to this Commission is that there is unfair discrimination in exemption of the factory mutuals from income tax.



In order to maintain that they were bound to say just what they did, "Of course we admit that if we are going to get so-called equality here, we must concede it there," so they recognized in their brief that the two stood or fell together on the principle of equality. That is putting it on their case.

As far as we are concerned, what I say is this. That is an income tax as such in the case of the factory mutuals, for two reasons. First, it is a tax on gross income, as distinct from net income. Second, it is a tax on net investment income. Net investment income is the subject of taxation under the Income War Tax Act and the Excess Profits Tax Act, for all forms of business, and therefore is a subject-matter with which those acts deal. If it was possible to find a taxable profit in the factory mutuals under the Income War Tax Act, you would have to use that item, which is now taxed under the Special War Revenue Act, to produce it. Do I make myself clear there?

THE CHAIRMAN: I think so.

MR. GRAY: Therefore that is relevant to the application of the Income War Tax Act to the factory mutuals. Now, on the top of page 2 of the supplementary brief, I read the first paragraph only. I am not reading the figures at the bottom of page 1, because the Commission will have those before them.

"The marine insurance premiums written in Canada would, if included at 1943 levels, add about \$10,000,000 to taxable premiums. At present, only marine premiums received by domestic companies are assessed for income and excess profits taxes and all marine premiums are excluded from Special War Revenue tax. It is accordingly estimated that a uniform tax



of 4 per cent on all insurance premiums, other than life, would produce about \$2,435,000 additional revenue, or a total of about \$4,750,000 annually."

THE CHAIRMAN: I assume, Mr. Gray, that as far as the 4 per cent tax is concerned, you approve of it provided it is extended to your competitors ?

MR. GRAY: Yes, Mr. Chairman. The investment income might be dropped from both; that is a matter for the minister to consider, but we are content to leave our tax as it is if the others are put on the same basis.

The brief follows:

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Brief submitted on behalf of the  
Factory Mutual Fire Insurance Companies

Mr. Gray

"I. INTRODUCTION"

"All insurance of property or estate is fundamentally co-operative and mutual in character, regardless of the type of insurer which undertakes to serve the insured. The business is merely the collection, from many individuals who are exposed to risk of loss, of the moneys necessary to indemnify those few who suffer loss from the insured perils, and of the cost of carrying on this service of collection and distribution of money. In all cases money contributed by policyholders supports the enterprise and only those insurers survive which collect enough from the insured to fulfill their contracts and to maintain their services.

"But some insurers do differ from others by adding to this fundamental service of collection and distribution of money, an active engineering service devoted to prevention of loss from certain insured perils such as fire and explosion. Obviously, little can be done by human agency to reduce the risk of earthquake or tornado but something may be done by supervision of construction of buildings to reduce the consequent loss from such disasters, and much is being done by certain insurers to reduce the hazards of fire and explosion in industrial and commercial risks. The extent of the preventive service rendered and the degree of its effectiveness determines the element of additional cost thereof; it may reduce the loss cost more than it adds to expense.

"There is a difference among insurers which divides all these into two classes, namely; self-insurers, sometimes called mutuals (Which provide insurance at cost, without any element of profit to any proprietor other than the policyholders) and insurers not owned by the policyholders, which are conducted to make a profit for the entrepreneurs. One



other classification divides all insurers, namely: incorporated and unincorporated associations.

"Thus the field of property and estate insurance may be represented as enclosed by a quadrilateral of which the sides are four types of insurers, namely: joint stock companies and Lloyds underwriters, mutuals and reciprocals. Stock companies and mutuals are incorporated insurers; Lloyds underwriters and reciprocals are unincorporated. Joint stock companies and Lloyds underwriters are organized and conducted for profit; mutuals and reciprocals are self-insurers, organized and conducted by policy holders for their own benefit. These four main types constitute all classes of insurers now engaged in this kind of insurance business in Canada.

"No doubt it has already become clear to members of this Commission that the business of merchandise distributing co-operatives is quite dissimilar from self insurance. Most of the material submitted to this Commission in Western Canada, respecting merchandising co-operatives, seems quite irrelevant to questions respecting taxation of insurers. It is, therefore, respectfully submitted that this Commission should deal with the problems of insurance taxation from a viewpoint entirely independent of views respecting trading co-operatives generally.

"So far as the factory mutuals are concerned, these insurers have no insurance obligations to any persons other than their own members and do not collect premiums from any persons except their own members. The Canadian members of the factory mutual companies are all engaged in trade and their own trading accounts are, without exception, subject to all the tax impositions of trading corporations. No





exemption of the factory mutual member from taxation exists or is sought.

"This submission does not pretend that self insurance fills, or could fill, completely the requirements of Canadian business and credit. All of the above-mentioned types of insurer, (joint stock companies, Lloyds underwriters, mutuals and reciprocals), are useful and necessary servants of the Canadian economy. All should be encouraged to render their best and peculiar services to the prevailing competitive system of individual and public enterprise by appropriate public regulation. It is obvious that fair and equitable taxation can preserve the benefit of these competitive services and that unfairly discriminatory taxation may be used to the prejudice of one or more types of insurer in such a way as to deprive the insuring public of its services.

"An example of such unfairly discriminatory taxation appears in the special war revenue legislation of 1931 (21-22 Geo. V. Cap 34 s. 16 (1) (a)), which was declared ultra vires by the Judicial Committee of the Privy Council before it came into effect. (1932 A.C. 41) If that legislation had been maintained and applied, every Canadian member of a factory mutual insurer would have been compelled to pay an annual tax of 15% of gross premium deposits in addition to the 1% premium tax paid by the company. This additional tax was, at that time approximately three times the total annual expenditure for losses and expenses in the system. Obviously such legislation would have compelled the factory mutual companies to abandon the provincial licences to carry on business in Quebec and Ontario which they then enjoyed and to withdraw from business in Canada. It seems





that in that case, at least, the courts were a better protector of the public interest than was Parliament itself. There is, therefore, a responsibility on this Commission to make recommendations of methods of taxation of this insurance business, which will be appropriate to the organization to which it is to be applied, and will thus be discriminatory, but not unfairly discriminatory in its application.

"Much misinformation has been given to the public, and especially to agents of joint stock insurance companies, about the present tax levies on fire insurance business. This has created a mistaken belief that the provisions of section 4 (g) of the Income War Tax Act exempt mutual corporations from fair taxes and confer a competitive advantage upon mutual insurers to the prejudice of the agents of stock companies. This untrue propaganda has been easy to maintain because the deposit premium mutuals do not employ commission paid soliciting agents. The associations of stock company agents know that the whole insurance agency system is in competition with these non-agency insurers. But this brief seeks to show that, in fact, the burden of unfairly discriminatory taxes has been imposed on the deposit premium mutuals and not on the joint stock insurers, under present statutes and regulations. The deposit premium mutuals welcome this enquiry in the expectation that its findings as to facts will dispel misinformation and misunderstanding, not only among the general public, but even among the commission paid agents of joint stock insurers.

#### 11 - GENERAL SUBMISSION

"If the Commission is authorized to consider any type of insurance enterprise whatever, it is submitted that no single type of insurer is beyond the scope of this enquiry,



inasmuch as the whole business of insurance is, in its nature, co-operative. For example, one could hardly consider the application of income and excess profits taxes to self insurers, without regard to the fact that British and foreign stock insurance companies are not subject to Canadian taxes under these statutes in respect of investment income. This fact was ignored when investment income of the factory mutual fire insurance companies was made (and still is) subject to double taxation by the Special War Revenue Act in the hands of the insurer, and by the Income War Tax Act and Excess Profits Tax Act in the hands of the policyholder. The fact that this income tax is imposed on the insurer by a statute under a different name, does not make it irrelevant.

"Nor, we submit, could the application of income and excess profits taxes be considered by this Commission without regard to the fact that the factory mutuals now pay a premium tax in Canada under the Special War Revenue Act at double the rate applied to stock companies.

"The factory mutuals are not concerned whether stock companies pay or do not pay income and profit taxes. Such taxes do not affect the competitive activity of joint stock insurers because they do not enter into the premium rate structure for stock company insurance; their existence or non-existence does not affect premium rates charged the insured. There is therefore no competitive advantage or disadvantage in the taxation or exemption of stock companies from income and excess profits taxes -- other representations to the contrary notwithstanding. If, however, some tax is designed, which, by arbitrary definition taxes "profit" where there is no profit, insurance costs to the insured are immediately affected by the final incidence of such taxation. That is





the kind of taxation which the factory mutual companies desire, respectfully, to oppose on behalf of their members.

"Furthermore, while the factory mutuals do in material respects hereinafter described differ from other kinds of mutual insurance corporations, they are like other mutuals in being wholly owned and controlled by their insured members, and in having no income or assets not fully owned by and distributable to or for the account of policyholders. Profits in the nature of taxable income simply do not exist in the mutual system, any more than they exist in a stock company which, on its operations, merely "breaks even." If profit does not exist, one cannot tax it! No one has yet suggested that a stock company should pay income tax when its income and outgo on operations are equal. Why is it supposed that a mutual could be different in this respect?

"The law has consistently maintained this principle in Canadian, American and British jurisprudence. It was not section 4 (g) of the Income War Tax Act which created an exemption. The law had already recognized that an assurance company which consisted entirely of members having participating policies (but not shares) was held not to be earning profits of a trade by effecting insurance among its members (New York Life v. Styles (1889) 14 Appeal Cases 381) and this decision was followed in the case of a company (limited by guarantee) formed among employers to indemnify its members against liability for compensation in respect of fatal accidents, although it did not repay to its members the surplus receipts from premiums, but carried them to reserve (Jones v. S.W. Lanes, Coal Owners Association Limited (1927) A.C. 827). Section 4(g) of the Income War Tax Act was merely declaratory of the common law and made no change in it.





"If, however, additional contributions from mutuals and reciprocals to public revenues are required (and this submission admits such a presumption) then it ought not to be achieved by giving the word "profit" or "taxable income" false or arbitrary meanings by statutory definition. That has been done in the United States. It is quite possible to prescribe measures of taxation of uniform application to the insurance business by which the public revenue requirements may be served, (as will be shown hereinafter), without attempting to apply income and profit taxes to activities which produce no profit.

"It may also be important to this Commission to consider how it happens that stock company income taxes and excess profits taxes bulk so largely in national revenue in war time. War conditions have greatly increased fire insurance revenues without, (fortunately for Canada) increasing the losses and expenses proportionately. Special war risk indemnities have been sold by fire insurance companies in Canada and the United States, at rates which anticipated serious losses - losses which did not happen. The initial rate was wisely made high to cover unknown risks -- but the mutuals and reciprocals gave back to their policyholders a large portion of this excess collection in their unabsorbed premium deposit return; not so the stock companies. Those high premiums produced high profits and high taxes, for which the stock companies seem to claim some merit as contributors to public revenues, regardless of the increased profit to stockholders of which these taxes are only a part. It is a strange misrepresentation of merit if these high profits and high taxes of stock companies could be a reason or excuse for over-taxing the factory mutual companies, which have already

1. The first part of the report deals with the general situation of the country and the progress of the war. It is a very interesting and informative account of the events of the year.

2. The second part of the report deals with the military situation. It gives a detailed account of the operations of the army and the navy, and the progress of the war on the various fronts.

3. The third part of the report deals with the economic situation. It gives a detailed account of the production of food and raw materials, and the progress of the war on the economic front.

4. The fourth part of the report deals with the political situation. It gives a detailed account of the activities of the various political parties, and the progress of the war on the political front.

5. The fifth part of the report deals with the social situation. It gives a detailed account of the activities of the various social organizations, and the progress of the war on the social front.

6. The sixth part of the report deals with the cultural situation. It gives a detailed account of the activities of the various cultural organizations, and the progress of the war on the cultural front.

7. The seventh part of the report deals with the scientific situation. It gives a detailed account of the activities of the various scientific organizations, and the progress of the war on the scientific front.

8. The eighth part of the report deals with the legal situation. It gives a detailed account of the activities of the various legal organizations, and the progress of the war on the legal front.

9. The ninth part of the report deals with the medical situation. It gives a detailed account of the activities of the various medical organizations, and the progress of the war on the medical front.

10. The tenth part of the report deals with the religious situation. It gives a detailed account of the activities of the various religious organizations, and the progress of the war on the religious front.

returned or credited the savings on high-rated war risks to the policyholders who contributed it on a premium deposit plan.

"Of course, war conditions merely underlined and exaggerated pre-war conditions in respect of fire insurance profits both in Canada and the United States. For whatever value the record may have (the figures are not prepared by us) the Dominion Insurance Department Blue Book - 1940 - Vol. I, at page XII, sets out that in sixty-six years, 1875 to 1940, the excess of premiums received by British companies in Canada over all losses incurred and expenses and taxes paid was \$60,549,557. This amount is 7.94% of the premiums. (The British companies are referred to because there are no mutual corporations among them.) Now this underwriting profit is in addition to the investment income and any other income earned by these companies in Canada, of which the greater part is earned by investment of funds contributed by policyholders. It has never been necessary for fire insurance joint stock companies to earn any underwriting profit whatever in order to enjoy handsome returns on capital invested in the fire insurance business in Canada and the fact that such underwriting profits have been gained after charging to that account all taxes, as well as expenses and losses, seems to take some of the edge off the following bathetic declaration found in the brief submitted to this Commission by the Insurance Agents Associations of Edmonton, Calgary, Lethbridge and Medicine Hat at the Edmonton session on January 27th, 1945.

'In conclusion we submit that the present high level of taxation is in large measure due to costs arising out of the war and that the war is being fought by the citizens of





Canada in the interests of all citizens of Canada, and that the tax burden of the war effort should therefore be equally borne by all citizens of Canada, but that under the conditions as they exist today some of the citizens of Canada are paying the cost for a war that is being waged in the interests of all.'

"Since it was moneys collected by British insurers from Canadian policyholders that paid all these extraordinary profits to non-resident shareholders, it is difficult to see just how the declaration of these agents, who no doubt experience hardship in meeting their individual tax demands in these difficult days, should think it their duty to come to the aid of a system of insurance which has done so well for its proprietors, notwithstanding war conditions and war taxation. As for the factory mutuals, if they returned to Canadian policyholders their savings in the cost of fire insurance, with the effect that these policyholders were able to reduce their expenses and pay higher income and excess profits taxes to the Dominion Treasury, whose was the greater contribution to Canada's economic stability and fiscal solvency, joint stock insurers of British and foreign origin or the factory mutual self-insurers?

### III - BUSINESS OF FACTORY MUTUAL COMPANIES

"The group of eleven fire insurance companies, commonly known as the "Factory Mutual Companies" and registered under the Foreign Insurance Companies Act of Canada, are similar in corporate form and method of operation. They were incorporated and have their head offices in the United States, four in Rhode Island, five in Massachusetts, one in Philadelphia and one in Chicago. Names and addresses of the company head offices are listed in Appendix "A". They have a combined





Records Office for Canada in Toronto and certain of the companies have branch offices and resident representatives in Toronto. All of the companies operate on a purely mutual premium deposit plan hereinafter explained.

"The companies were originally organized and are still owned and controlled by policyholders, for policyholders. No portion of the earnings of these companies remaining after providing for operating costs and reserves can enure to the benefit of anyone other than the policyholders. The number of policyholders is small enough to ensure that the responsibility of the management to the policyholders is real and effective. The object is prevention of loss by fire, through continuous expert engineering service, and indemnity of members for loss by fire and allied risks, on the mutual insurance plan. The companies have no capital stock and no shareholders.

"The oldest of the companies commenced business in 1835 and the youngest, in 1887. They have been registered under Dominion Law since 1936 and have been licensed in Ontario and Quebec since 1927. They have insured manufacturing risks in Canada at least since 1873. It is on record that in that year a group of Canadian manufacturers engaged in the woollen industry in Eastern Canada came to Providence to persuade the factory mutual insurers to extend the benefits of their inspection and insurance service to Canadian risks. The companies are now licensed and carry on business also in twenty-three of the United States of America.

"The companies insure almost exclusively manufacturing and commercial properties of high-grade construction, fully equipped with automatic sprinklers, all according to their own strict specifications. The total amount of insurance in



the factory mutual system in Canada and the United States as of December 31st, 1943 amounted to more than \$16,700,000,000. in about 10,500 individual risks. The total amount of risk in Canada in the system as of the same date was \$967,689,711. (approximately 7% of the total). This Canadian insurance consists of 837 separate risks, giving an average amount of insurance in Canada per risk of \$1,160,000., which compares with an average amount for single risks in the whole system of \$1,590,000.

"The premium deposit made by members at the time insurance is undertaken has varied from eight to twenty times the net cost of insurance for one year. These deposits constitute a fund from which the cost of insurance is taken. That this is not a "premium" is shown by the fact that the deposit is the same amount whatever the term of insurance. The average proportion of the premium deposit absorbed by cost of insurance for the year 1943 over the system is approximately 10% of the amount of the premium deposits. The excess, amounting to 90% of the deposit, called the unabsorbed premium deposit, remains at the credit of the member at the end of each policy year and is repaid to him at the termination of the insurance.

"The amount of moneys held by the companies for the policyholders, in Canadian securities, may be compared with the total amount of premium deposits received from Canadian members at the end of 1943 as follows:

Canadian Premium Deposits in force	\$5,756,404.
Investments in Canadian Securities	9,275,991.

(Made up as follows:- Dominion Government Bonds \$7,023,753.; Provincial, County and Municipal Bonds \$319,413.; Railway and Public Utility Bonds \$534,665.; Miscellaneous Stocks \$267,175.; Bank Stocks \$149,788.; Bank Balances in Cash \$981,197.)





IV - METHOD OF OPERATION OF THE FACTORY MUTUAL COMPANIES

"The membership of the companies is confined to its policyholders who are insured against damage by fire, including allied coverages such as lightning, windstorm, sprinkler leakage, explosion, etc. The control of each company is entirely in the hands of its policyholders in Annual Meeting and its Directors, all of whom are elected by policyholders.

"The Manufacturers Mutual Fire Insurance Company was the first company of the group to be formed. It commenced business in 1835 at the City of Providence, Rhode Island. From that day to the present time, the factory mutual companies have been leaders in America in development of the science of fire prevention. The fire prevention engineering service is operated by the companies jointly, through regular inspection and reports carried out by specially trained fire-prevention engineers. The service in Canada and the United States is integrated on a continental basis. Industrial plants of the same class, wherever located, receive the same specialized service.

"All the policies are written on a premium deposit and assessment basis and no insurance whatever is undertaken on a fixed premium basis. Every policyholder participates in the savings shown on cost of operation. Upon the termination of the contract, every policy receives credit for or return of the unused or unabsorbed portion of the original premium deposit, the percentage varying with the losses and expenses of each of the companies and the length of term the policies have been in force. All the policies are subject to an assessment (limited to five times the original premium deposit) in case the funds in hand prove to be insufficient. In the long experience of the system, no company has ever had to make





an assessment.

"The method of operation of these companies is different from that of any other company or group of companies. At the beginning of the policy term, a deposit is made which is known to be several times (actually eight to twenty times) the amount that probably will be required to pay losses and expenses. During the life of the policy, each deposit is charged each month with its pro rata share of the losses and expenses and contributions to reserves; at the expiration or cancellation of the policy, a summation is made of these monthly charges and the balance of the deposit (that is, the amount which is unused or unabsorbed) is returned to the policyholder. This return of unused deposit is expressed as a percentage of the original deposit and the amount thus returned diminishes as the length of term of the policy increases.

"The initial premium deposit is the same for all policy terms and is the same for all risks with the same specifications. It varies somewhat between individual properties of different classifications in accordance with what experience has shown to be a proper measure of the difference in hazard. Having this in mind, it is apparent that the premium deposit is vastly different from the flat premium charges by stock fire insurance companies. In the one case it is a sum deposited with the company out of which the losses and expenses (the true premiums) are to be taken. In the other, it represents the cost of insurance to the policyholder. If, in the one case, the premium deposit is in excess of the amount required for the purpose of the company, then such excess is returned to the policyholder. If the premium paid to the stock fire insurance companies is more than is needed to pay losses and expenses, then the excess represents



profit to the stockholder of the insurance company and no return thereof is made to the policyholder. In the latter case, the premium represents the cost of insurance and includes the element of profit. In the case of the factory mutual companies there is no such element as profit to the insurer.

#### V - NATURE OF THE PREMIUM DEPOSIT

"A fact which must be kept clearly in mind at all times is that the original deposit, which is purposely large in the case of the factory mutual companies, is a deposit and not a premium in the usual sense of the word, and that the companies are at all times accountable to their members for the unused portion of the deposit. For instance, if the business of the companies was such that it could all be written to begin January 1st of each year and to expire on December 31st of the same year, it will be seen that after having paid the losses and expenses, the companies have available for return to the members the unused deposit which varies between 88% and 94%.

"However, the business of insurance is a continuing business. Contracts of insurance are written for fixed terms. They do not all expire at the same time and when they expire most of them are renewed. Therefore, it would not be possible to effect an annual or other periodic liquidation of an insurance company's business, distribute its assets and begin to transact business anew. If that were possible, one could very easily demonstrate that, in case of the factory mutuals, at any rate, there is no surplus as that term is ordinarily understood, due to the fact that all funds of the company belong exclusively to its policyholders, and in case of liquidation are distributed among





them in accordance with the terms of the Charter of the Company. A typical provision is that which appears in the Charter of the Manufacturers Mutual Fire Insurance Company, which reads as follows:-

'Provided that in case of the liquidation of the corporation, except in case of merger or consolidation or the general reinsurance of all its outstanding policies, all persons, firms, associations and corporations who within six years last past before the date of the vote to go into liquidation, have been members of the corporation, shall be entitled to share in the distribution of the reserve, and other assets, after payment of liabilities, ratably in proportion to the amount of premium deposits paid by them to the corporation for insurance on the mutual plan within said period of six years.'

#### VI - ALL FUNDS BELONG TO POLICYHOLDERS

"The assets and income of the factory mutual companies can be used only in the following ways:

1.           (a) the payment of losses;  
             (b) the establishment of a fund or reserve  
                    to pay the larger or unusual loss, such  
                    as conflagration.
2. The payment of expenses and taxes.
3. Loss on securities sold at a loss.
4. The return of unused portion of the premium deposit at expiration of the policy.
5. The return of the unused assets to the policyholder in case of liquidation as provided by the Charter.

"There is no other way in which the funds of the companies may be used.





VII - RELATIONSHIP OF CANADIAN BUSINESS TO THE FACTORY  
MUTUAL SYSTEM

"Both legally and as a matter of fact, the Canadian membership and Canadian risks and Canadian service of the factory mutual companies are completely integrated in the continental system in which these companies operate. Canadian members share pari-passu in all the rights, privileges and liabilities of the general membership. In the business administration of the companies, the Canadian risks are classified with United States risks of similar use and physical hazard for rating, underwriting, inspection and supervision. It is impracticable to do otherwise. Most of the expenses of operation of the companies are incurred through the head offices of the companies in the United States or through the joint inspection department, of which the head office is in Boston. All expenses of operation, including taxes, are pro-rated over the whole membership, in proportion to the premium deposit of the individual member. Over the whole system, the Canadian risks amount to about seven per cent of the total, and consequently, the losses and expenses charged to Canadian members' accounts are approximately seven per cent of the total of such losses and expenses. This is, of course, as it should be, having regard to the mutuality of members, which is the essence of the system. The apportionment of losses and expenses among the membership is not a theoretical or conventional assumption; it is an actual and legal basis of the liability of members and it is a true accounting method.

VIII - THE SPECIAL WAR REVENUE ACT

"Section 14 of the Dominion Special War Revenue Act, as enacted in 1932, provided a rate of 1% on net premiums



for joint stock fire insurers and 2% of net premiums for mutual companies operating under the premium deposit plan. This is the first enactment known to the companies in which a different rate of premium tax has been fixed for stock and mutual companies. There is no such distinction in the same statute in relation to the tax on life insurance premiums. No province of Canada and no state in the United States has made any such discrimination in rate of tax.

"Section 13 (f) as enacted in 1932, included for the first time, the clause which, in the case of premium deposit mutuals and reciprocals add to "net premiums" for taxation, interest on the unabsorbed premium deposit. In so far as known to the companies, this provision is not found in any other jurisdiction. It is, in fact, not a premium tax at all, but a form of income tax levied by a statute under a different name. The discrimination between stock companies and premium deposit insurers was aggravated by this definition. In 1932, this artificial definition almost doubled the tax imposed. In 1945 it adds, on the average, about one-third to taxable premiums.

"Since 1942, the factory mutual companies are subject to and pay a special war revenue tax of the Dominion under Section 14(3) at a rate of 4% of net taxable premium (specially defined as above), although stock companies insuring similar risks pay only 2% of net premiums under Section 14 (1). The tax payable on 1943 premiums of the factory mutuals under the Special War Revenue Act was \$34,632. In addition, the companies have paid taxes and license fees imposed by the provinces of Canada which, when combined with this Dominion tax above-mentioned for 1943 premiums, amount to \$44,364.





"The average premium rate for fire insurance in Canada for 1942 (as reported in the Dominion Insurance Blue Book at page X) is 66 cents for \$100 of insurance for one year. That is the average for all companies on all classes of risks. Taking the British companies, among which there are no mutuals or self-insurers, the same table shows an average fixed premium rate of 62 cents per \$100 of insurance taken in Canada. The average rate of premium deposit required for the factory mutual companies for 1942 was 58 cents for \$100 for insurance (protected manufacturing and mercantile risks only). Of this average premium deposit, the factory mutual companies give back to their policyholders after insurance for one year, an average of 90%; which is about 52 cents. The net amount of the average mutual premium deposit absorbed by the company is, therefore, about six cents for \$100 of insurance. To add interest on 52 cents for a year to taxable net premiums, increases the tax payable by about one-third. The stock company does not return to the policyholder any part of its initial premium; yet, the stock company is not required to add any item of interest on premium or premium reserves to its taxable premiums. Neither should mutual companies be required to do so.

"It is respectfully submitted that the taxable premium should be the amount of the net premium retained by the company both in the case of the stock company and the mutual insurer, as is the case in taxation of life insurance premiums, and that the rate for all types of insurance should be the same.

#### IX - "UNDERWRITING ACCOUNT IN CANADA"

"The annual statement form required by the Dominion





Department of Insurance from all British and foreign companies, in the account entitled "Underwriting Account in Canada," misrepresents the Canadian business of the factory mutual companies. It purports to show the Canadian business of the factory mutual companies as a separate compartment of their undertaking, and thus to ascertain the result of the Canadian operations: a method which is quite impracticable and incorrect. This, of course, is well understood by the examining officials of the Dominion Department of Insurance, but unfortunately, the reproduction of the figures presented by these annual statements in the published Blue Book of the Department has lead to considerable public misunderstanding of the operations of the premium deposit mutual companies. The balance of the account on page 14 of the Annual Statement has been carried into the Blue Book in an aggregate described as "Underwriting Profit" "Deposit-premium Mutuals," in the special schedule in the 1942 Blue Book at page LXVII and following pages, as "Non-taxable Underwriting Profit." Both of these representations are incorrect and misleading as to deposit premium companies. No criticism of the exhibit is intended in its application to fixed premium fire insurance companies; it simply is not appropriate for the factory mutual system.

"Exhibits I and II, set out in appendix "B" compare and contrast the actual results with the figures in the table on page 14 of the Annual Statement of the Manufacturers Mutual Fire Insurance Company (one of the factory mutual group) in respect of business for the calendar year ended December 31st, 1941. Exhibit I is a copy of that statement. It will be noted that the words "underwriting gain" and "underwriting loss" as printed in the exhibit have been struck out by the



company when filling in the return, and this is the uniform practice of the factory mutual companies when completing this return. This deletion is intended to call attention of the Department examiners to the fact that the exhibit does not result in ascertainment of what is generally regarded as underwriting gain or underwriting loss. Those who prepare the Blue Book have ignored this reminder.

"Exhibit II is a showing for the same company for the same period, on the same facts, of the operating surplus of the company, both with and without investment income taken into account. The underlying principle of Exhibit II is that Canadian members assume liability for and pay that proportion of the total losses and running expenses of the company which the total of Canadian premium deposits in force on December 31st, 1941, bears to the total of all premium deposits in force in the company on that date. This is the most practical representation of what actually happens in the company's operations over a period of twelve months.

"If an accountant wished to know what happened to the reserve of a factory mutual company during any period of operation, this Exhibit II will show as nearly as possible what was added to or deducted from (as the case may be) the reserves of the company, by reason of the operations of the period. Exhibit I certainly would not give any reliable information on this point. In using 8% of totals, the actual proportions in this company of Canadian to total premium deposits is applied. In another company the proportion would be different. In the aggregate of the system, the proportion is, as heretofore stated, about 7% instead of 8%.

"Exhibit II includes investment losses or gains and the unabsorbed premium deposit, on a proportional basis; the





expenses and losses incurred include the same proportion of all expenses and losses of the company wherever the same are incurred. A comparison of the corresponding figures in the two exhibits shows every item irreconcilable with its counterpart. One can see at once how wide a discrepancy exists between the resulting debit of \$23,293 for the underwriting account, excluding investment income, under Exhibit II and the credit balance of \$106,977.58 under Exhibit I. It is the latter figure which is carried into the totals for premium deposit companies in the tables on page XLVII of the 1942 Blue Book. From this the importance of the point we have to make may be gauged in relation to the whole exhibit in the Blue Book.

"The items in Exhibits I and II are discussed in detail in Appendix "B".

"Now the Dominion Blue Book has aggravated the misrepresentation involved in this exhibit of deposit premium company operations by carrying these figures into an exhibit in the Blue Book purporting to set forth the situation respecting income and excess profits taxes paid or exempt under the present law at pages LXIX and following. Not only has the balance of the inaccurate statement form been carried forward in the aggregate as an underwriting gain or profit, but these same aggregate figures have been exhibited at page LXXII of the Blue Book as "Non-taxable Underwriting Profit." The plain fact of the matter is that if the true figures are used and rules are applied to factory mutual companies similar to those now applied to British and foreign stock companies (that is to say, the exclusion of investment income from the underwriting account) no deposit premium mutual develops any underwriting gain or profit on its operations.





"Demonstration that the publication of these figures in the Dominion Blue Book has actually misled the public and is in part responsible for the extension of the work of this Commission to the fire insurance business is seen in the leading article published in "The Canadian Underwriter" of Toronto for June 15th, 1944, under the title "Incidence of Taxes upon Different Classes of Insurers; Disparity of Treatment is Revealed by Dominion Superintendent of Insurance in his Report Covering the Business of 1942." Included in this article, which exhibits the figures above referred to as "non-taxable underwriting profit" appear the following statements:

'A member of a co-operative or mutual organization, on the other hand, pays no income tax on annual dividends received and because they are classified as non-profit organizations, the co-ops or mutuals themselves also escape payment of corporation income taxes and excess profits taxes. Just how this set-up works to the advantage of mutual companies and to the disadvantage of capital stock insurance companies is strikingly shown in the accompanying table taken from the annual report of Mr. G. D. Finlayson, Superintendent of Insurance, covering 1942 business. From this table it will be seen that reciprocal exchanges, deposit premium mutuals and other mutuals paid exactly nothing as income tax and excess profits, stock mutual companies paid \$49,461, joint stock insurance companies paid \$4,303,452.....The deposit premium mutuals reported a profit of \$633,232 on premiums of \$1,275,072 which works out at 49.66% ..... The really significant thing which comes out of all this, however, is the percentage of profit that each class of insurer was able to retain after taxes. Joint stock companies retained 1.93% .....premium deposit mutuals and



reciprocal exchanges retained 100% ..... This disparity in tax treatment can by no stretch of the imagination be characterized as "fair and reasonable" in view of the fact that the other mutuals operate for the most part on a national or international scale, giving the same coverage as stock companies..... Here is the picture in tabular form -

	<u>Premiums</u>	<u>Under- writing Profit</u>	<u>Income Tax</u>	<u>Excess Profits Tax</u>	<u>Profit After Taxes</u>	
Deposit- Premium Mutual..	1,275,072	#633,232	nil	nil	#633,232	100%
Joint- stock ..	82,919,802	5,907,143	1,592,746	2,710,706	1,603,691	1,93%

#, This figure of \$633,232 is the total taken from the Insurance Blue Book at page LXVII, Table A, 1942 and is, apparently, the total of the balances for all factory mutual companies for that year, taken from the annual statement forms of the companies on page 14. We can be certain that the correct figure, produced by the method applied in Exhibit II, would be a minus quantity.

"The Canadian Underwriter" has a wide circulation among fire insurance agents and brokers, as well as company men, throughout Canada and, it is submitted, is responsible for much of the misinformation hereinbefore mentioned. See also an address by Mr. A. Leslie Ham, Manager of the Canadian Underwriters' Association, Montreal, as printed in "The Chronicle" of December 11, 1942, at pages 885-887 for another example of obscurantist propaganda promoting the same misunderstanding of facts and feeding the same prejudice of ignorance.





X - INVESTMENT INCOME OF FIRE INSURANCE COMPANIES

"Speaking generally of all types of fire insurer, there are two main sources of revenue in operations. These are respectively designated by the names "underwriting account" and "investment income account." The Underwriting Account has been discussed at length in an earlier part of this memorandum. The balance of that account may be called underwriting gain or underwriting loss, as the case may be.

"In the Investment Income Account there will be credited all rents, interest and dividends earned on invested funds of the insurer during the year and the balance of profit or loss on the sale of securities during the year. The expenses of management of the investment business of the insurer should be properly included in this account and deducted from revenue, though in some cases no effort is made to segregate these from the general expenses of the insurer. In accounts submitted to the Revenue Department of the United States, an estimate of one-fourth of one per cent of the mean of the invested assets is allowed as the expense of investment management and this deduction in Investment Income Account reduces the general expenses shown in the Underwriting Account.

"The major portion of the funds invested by all insurers, from which this investment income is derived, is money contributed by policyholders. They are reserves for unearned premiums, reserves for unpaid losses incurred, conflagration and contingency reserves and surplus, all derived from policyholders account. Actual capital contributed by shareholders to joint stock fire insurance companies represents a relatively small portion of the invested funds of the company and is only significant in a young and small company.

"In the case of the factory mutual insurance companies, and most other mutuals, all of the money in the hands of the





company for investment is contributed by policyholder members of the company and by no other interest whatever. In the case of the factory mutual companies, operating on the premium deposit plan, the income from investment over a period of more than forty years is generally greater than either the expenses or the losses for the period. Obviously, therefore, an underwriting account which excluded income from investments would always show a deficit for any accounting period after the unabsorbed premiums are paid or charged to the account.

"Under the present administration of Income War Tax and Excess Profits Tax Acts in Canada, income from investments is entirely excluded from revenue accounts of British and foreign insurance companies carrying on business in Canada, in so far as their Canadian accounts and taxation are concerned. What then, do those witnesses mean who tell this Commission that they wish to have income and excess profits taxes applied to the factory mutual companies on the same basis as to joint stock insurers? The result of such application would produce no tax whatever from factory mutual operations!

"Those representations must mean that those people who are pressing this Commission for new taxation upon factory mutual insurers wish to have, not equal treatment of insurers, as they profess they do, but some special formula devised which will impose upon these mutual insurers some additional burden of taxation, on a principle different from and inconsistent with that applied to joint stock companies under the Income and Excess Profits Tax Act. If so, they should now put forward their proposals for criticism, instead of relying on misinformation and meaningless slogans like "Equal treatment for all," or "taxation according to ability to pay."



"This line of enquiry should be pursued to a further conclusion, that is to say; by their very nature, income and excess profits taxes do not form any part of the premium rate structure under which joint stock companies carry on business. Premium rates are determined on the basis of exhibits which exclude both investment income and income taxes from the account. Therefore, a change in income and excess profits taxes by increase or decrease does not affect the premium rate level which is charged to the public for fire insurance on the fixed premium plan. It is quite mistaken therefore to suppose or state that the existence or non-existence of income taxes on joint stock insurers is a factor in the competition of these carriers for the available fire insurance business on the basis of rates of premium charged. Stock company insurance agents have been misinformed on this matter.

"It is quite otherwise with the deposit-premium mutual; since these insurers give their members insurance at cost and return or credit to their policyholders all the savings out of the deposit premium after payment of losses and expenses, and include therein all investment income, any increase in taxation of any kind, whether it be premium taxes, income and excess profits taxes or realty tax, all tend to reduce the unabsorbed premium deposit returned or credited to members and are consequently a charge to policyholders. Our competitors are therefore well aware that any additional taxes affect mutual policyholders' costs even when they do not affect stock company tariff rates.

"In an earlier part of this memorandum, it was stated that investment income of factory mutuals was doubly taxed in Canada: First, under the Special War Revenue Act, when interest on the unabsorbed premium deposit is made subject





to the premium tax rate of 4% and again, when the investment income is credited to the policyholders premium deposit account and so increases by an equal amount, the "saving" or "dividend" called the "unabsorbed premium deposit." That "divy" is taxable income in the hands of the policyholder member and subjected both to income war tax and excess profits tax. With the joint stock company this revenue from investments escapes income tax and excess profits tax at both these stages: The Special War Revenue Act contains no such provision regarding stock companies and the stock insurers return no "divy" whatever to policyholders.

"To make this very plain, assume a factory mutual member takes a policy of insurance for one year on which the premium deposit is, say.....\$1,000.00

Computations show the cost of	
insurance for the period of	
the policy is, say,	\$100.00
During the time the policy has	
been in force the premium	
deposit of \$1,000 has earned,	
say,	<u>40.00</u>

The balance chargeable to the	
policyholder then is	<u>60.00</u>
And the amount returnable to	
the policyholder, as a co-	
called dividend, is	\$940.00

"The insured is allowed as a deduction from income, the cost of doing business, which includes amounts paid for insurance on his business property. In the above example, the premium deposit of \$1,000 is probably entered in his accounts as a disbursement for prepaid insurance, and, on the





basis of previous experience, he may set up, as an asset in his statement, the expected dividend return or unabsorbed portion of the deposit thus carrying from year to year, as a deduction from income only the absorbed portion of the premium deposit. But assume for the purposes of this illustration that the whole \$1,000 of premium deposit is taken as a deduction from income in the year in which it is paid out; then, when his policy expires, it is found that the cost of insurance has not been \$1,000 it has only been \$60 and he has received back the excess of his deposit, or \$940 (which includes the \$40 of investment income shown above). In this case, he must then in his tax return in the year in which he receives back this sum, account for it as income and be taxed upon it. But, as we have seen, the cost of his insurance has been reduced by his share of the earnings on the invested assets of the company. It follows, then, that there is a corresponding increase in his taxable income. It is not essentially different if the taxpayer is charging off merely the absorbed portion of his premium deposit annually, because in that case, as in the other above stated, he is having the benefit of the investment earning on his premium deposit, credited through the insurer's accounts, when the net cost or rate of absorption is ascertained.

"To state this another way, if the policyholder in our hypothetical case had not received his share of the investment income of the insurance company (\$40.00) then his cost of insurance would be that much more, and his allowable deduction would have been correspondingly. Investment income of the factory mutual companies is, therefore, now taxed. It is taxed where it should be - that is, to the persons to whom it belongs and who are entitled to it and actually receive it.



The factory mutuals do not complain of this last-mentioned impost; they do protest on behalf of their members against the double taxation involved in the Special War Revenue levy against interest earnings and against any additional levy on investment income in the hands of the insurer which may be proposed.

XI - POLICYHOLDERS IN FACTORY MUTUAL COMPANIES ARE SELF-INSURERS

"The only difference between insurance provided by the factory mutual companies and the owner of property who insures himself - that is, carries his own risks - is that in the one case, the protection is provided in corporation form whereas in the other, it is done individually. In both cases, they are self-insurers.

"Let us assume a manufacturer has decided not to purchase insurance protection for his property. Actually, instances of this nature could be cited. If the property owner is prudent, he will establish a fund to be nourished from time to time out of earnings, against which any losses incurred will be charged. This fund, if sufficient, will reimburse him for any losses sustained. If he does this, manifestly, he will cease paying insurance premiums and he will have protection at cost.

"If, now, instead of establishing such a fund individually, he associates himself with other manufacturers, and they all contribute to a common fund, each in proportion to the amount of his protection, then all are likewise self-insurers and, as in the case of the individual self-insurer, they will receive their protection at actual cost.

"Such an association as we have outlined may be operated either in corporate form or as a voluntary association. If it functions as a voluntary association without purpose of





profit, all for the benefit and protection of its members, then there is no more reason why it should be included within the provisions of income tax laws than there is to tax an individual manufacturer who carries his own risks - insures himself - and creates reserves for that purpose. They are both on an equal footing. They make no profit and, hence, there is no profit to tax. Individually, they may effect savings in the cost of doing business, and if they do, then such savings will be reflected in their profit statements and be taxed just as other profits are taxed in their hands.

XII - SELF-INSURERS HAVE NO TAXABLE INCOME

"If, now, individuals and associations of individuals insuring themselves in the manner we have outlined are held not to have any taxable income - and we submit they should be - then the question presents itself, why should there not be a like exemption when insurance protection is provided in corporate form, if, under that form, as in the case of Associated Factory Mutual Fire Insurance Companies, insurance protection is afforded at cost? The fact that a corporation exists does not, in and of itself, subject it to income tax, any more than is an individual or a group subject to tax if he or it has no profits and, hence, no taxable income. The rate of tax may differ, but the basis is the same. And so, it must be clear that these insurance companies, operating just as an individual self-insurer or a group of self-insurers operate - all without purpose of profit and solely for the benefit and protection of their members, and furnishing insurance to their members at cost, do not have any taxable income or profits and, hence, are not and should not be subject to tax; otherwise, what is there to tax? The deposits of their policyholders? They are not "income," within the meaning of





the income tax law. As well tax depositors upon their deposits in banks or amounts set aside as an insurance fund. Should they be taxed on their investment income? That is accounted for and is taxable to the policyholders who receive their respective shares of it in the returns of unabsorbed deposits which the insurance companies make. The situation here is no different than is that of the individual who insures himself, establishes and maintains a fund for that purpose, and invests it and receives income from his investment.

"Manifestly, such income as the insured receives is taxable, and that is true of policyholders in the factory mutual companies. They receive the income derived from the investment of their deposits and they must, under the income tax laws, report it and be subject to tax upon it.

#### XIII - SPECIAL CONTINGENCY RESERVES

"All types of insurer must have and maintain from year to year adequate reserves for special contingencies, which over a long period, are as bound to occur as are the expected losses in the annual periods. These are sometimes specially earmarked for a particular purpose - such as epidemics in life insurance, or conflagrations in fire insurance, or security-value collapses, in both; or they may be general reserves. Annual contributions to such reserves are, of course, allowed as deductions from income for taxation purposes if they are justifiable in purpose and amount.

"Factory mutuals are not different from other insurers in this requirement but they are different from joint stock insurers in that these reserves remain always the property of insured members and are eventually used for their account. Yet, for some reason, competitors point to all accretions to policyholders' reserves in the hands of the mutuals as if



these ought to be a special target for taxation. Actually, catastrophe hazards among factory mutuals are covered in large part by excess-loss re-insurance contracts, paid for by premiums deductible as an expense, so that even the large individual risk carried by the companies requires less reserve than if there was no such protection; but it will be recalled that the factory mutuals carry much larger individual risks than most other companies and, hence, need suitably large reserves.

"The reserves maintained by the factory mutuals fulfil the double function of meeting extraordinary loss requirements and security fluctuations and also of levelling out from year to year the net cost of insurance to the policyholder. There is nothing mysterious or surreptitious about these reserves nor can they have any purpose other than the due service of the policyholders' interests to whom they belong at all times.

"Insurance is a continuing business and averages for periods of years must be estimated so that both favourable and unfavourable experience shall be taken into account; for if good years and bad years do not equalize themselves -- ultimately, continued unfavourable experience means bankruptcy. Therefore, it is not only prudent but necessary to establish reserves in years of favourable experience to provide for losses suffered in unfavourable years. Taxation which discourages adequate provision for contingencies would do the policyholders and the state a serious disservice.

"In Appendix "C" of this brief is a diagram illustrating the variation from year to year of loss incurred in the factory mutual system, which demonstrates that a policy of loss reserves appropriate to the experience is absolutely necessary for the stability of the system. Even five-year average losses vary from \$203 to \$696 per million dollars of insurance







at risk, and in the single year 1914 losses reached a high point of \$1425 per million. In such circumstances adequate contributions to reserves are as proper and necessary deductions from income as are actual losses paid.

#### XIV - COMPARISON WITH LIFE INSURANCE TAXATION

"It may help to clarify understanding of the taxation problem of mutual fire insurance companies if we observe how income and profit taxes are applied to the life insurance business in Canada. In so far as the general public is aware, life insurance business is conducted by joint stock companies and by purely mutual companies, without the acrimony or complaint of unfair practices among competitive companies, which are so apparent in the Canadian competitive field of fire and casualty insurance. This is due, no doubt, to the fact that the life insurance business is better organized, that the social nature of the contract and the operations of the company are better understood by the general public and that the legislative situation has not been be-devilled by political pressure groups seeking special competitive advantages.

"Life insurance in Canada is subject to premium taxes and also to income and excess profits taxes. These latter are recognized and admitted to be what they were intended to be, namely, taxes on profit. The Income War Tax Act specifies in section 4(g) that only "such amount as is credited to shareholders' account" is liable to tax. In the life insurance field, purely mutual companies, from which no proprietor other than the policyholder derives any financial benefit, are not accused, even by the Superintendent of Insurance, of making a non-taxable profit for Income and Excess Profits Tax Act



purposes; and this is the case notwithstanding the fact that purely mutual life insurance companies occupy a much greater proportion of the life insurance field than mutual or self-insurers do in the field of fire and casualty insurance.

"Premium taxes in the life insurance field are applied to the net premiums in all cases, that is to say, to the residue after crediting the policyholder with all dividends earned on participating insurance. The portion of the income of a joint stock life insurance company from participating policyholders account, which may be diverted to shareholders' account, is limited by statute for Canadian Companies (See Canadian and British Insurance Companies Act (22-23 Geo. V, cap. 46 s. 80)) and in actual practice does not exceed five per cent, of the total income derived from use of policyholders' money or profit on underwriting account. It is only when such income has been actually transferred or credited to shareholder's account that it becomes subject to income tax or excess profits tax in Canada. This principle is a sound application of income tax, properly applied to the insurance business, whether it be the insurance of persons, of property or of estates. Inasmuch as these principles are unchallenged in the life insurance field, and inasmuch as the public revenue derived from the business is deemed adequate in relation to other sources of public revenue, it would be useful to understand why the same principles are not accepted in the fire insurance field.

"The first and principal reason is that the actual situation in the fire and casualty field has been misrepresented in insurance department publications, in the public press, and through propaganda agencies of joint stock





companies. Only a clear presentation of the facts by such an investigation as this Commission is conducting can turn back the ill effects of public misunderstanding.

"In the next place, the discrepancy between the cost of operation of the joint stock fire insurance business and that of the purely mutual fire companies operating on the premium deposit plan, without commission-paid agents, is greater than the disparity in cost between mutual and joint stock insurers in the life insurance field (where there is no non-agency system) and therefore competition in premium rate bears more heavily on the joint stock insurers engaged in fire business than in life insurance. Furthermore, joint stock fire insurers have not developed the participating policy as life insurers have done. But surely this discrepancy in cost of service is not to be made up by taxation, which discriminates against mutual insurance as a system of public service. If we take at its face value the demand of our competitors for equal treatment of mutual and stock company insurance under all taxation systems, no such result can occur.

"But the major consideration, which creates the crisis in the fire insurance field is the high rate of profit which joint stock fire insurance companies have been making consistently over a long period of years on their Canadian business. This long period of comfortable profit has produced an aggregate of profit taxes which, on the fact of the figures, represents a large contribution toward public revenue from this type of insurer. But some persons who observe this fact ignore the circumstance that after these taxes have been paid, a very large and generous profit remains to shareholders of joint stock fire insurance companies in the Canadian field of operation. Of course, this margin of





stock company profit has encouraged competition between the joint stock agency system and the purely mutual system of fire insurance. The growth of these forms of mutual insurance in Canada is the occasion of the out-ery from their competitors who seek, by any available means, to stop the progress of the mutuals. That they hope to use this Commission to that end is made very clear by the circular letter addressed by the Ontario Insurance Agents' Association to its members at the time the order-in-council appointing this Commission was under consideration by the government. A copy of that letter, dated November 10th, 1944, sent by the President to "all past-presidents, Council Members, Local Associations and Ontario Direct Members," is produced and will be filed herewith.

"The Income War Tax Act and the Excess Profits Tax Act are intended to assess and tax net profit on business operation; true profit taxes of this nature fall as a charge to the capitalist whose money is at risk in the enterprise. The incidence of this tax is such that it cannot be shifted by the proprietor of the business to his customer through increased prices, as taxes on gross income or sales taxes invariably are. A demonstration that taxes payable under the Income War Tax Act and Excess Profits Tax Act by mutual insurance corporations are not true profits taxes is found in the fact that if such taxes were collected from mutual insurers the immediate and direct incidence of this tax is upon the policyholder member in the mutual. This fact immediately creates that discrimination in tax between joint stock and mutual insurers, which is unfairly discriminatory and theoretically unsound.



XV - ALTERNATIVE TAXATION SOURCES

"The factory mutual companies expect to be subject to premium taxes as a means of raising revenue for public purposes. This source of revenue has recommended itself to all jurisdictions in which the companies operate. That the tax is at present a single impost by the Dominion Government, rather than a multiplicity of imposts by several taxing authorities, is a simplification of the tax system, which promotes economy in collection and makes for uniformity in distribution of the tax burden. Nevertheless the agreement under which the Dominion has exclusive recourse to this field is a temporary one, and this Commission has, no doubt, to take that factor into its consideration.

"The premium tax is a form of taxation of the insurance business, which, applied at a uniform rate and to a corresponding base for all types of insurer, secures an equitable distribution of the tax burden in the simplest possible form and with complete fairness to all competitive types of insurance. The principles upon which this premium tax has been applied to the life insurance business in Canada seems to be unexceptionable, if the rate of tax is fair. The factory mutual companies believe that a similar tax or a similar application of the premium tax to the fire insurance business would give the greatest satisfaction both to the government, the administering department and the taxpayer. The rate of tax can be raised or lowered as public revenues require in relation to other sources of tax revenue.

"It is true that the burden of this tax is passed on by the company to the policyholder. But that is the same with regard to any tax imposed on the factory mutual companies, and so cannot be an objection in so far as they are concerned.





"Unfortunately, the premium tax on deposit premium fire insurance companies provided by the present provisions of the Special War Revenue Act has distorted the application of this tax unreasonably and unfairly, to the prejudice of the factory mutual companies and the reciprocal insurers, to which the rate of 4% applies. The rate of premium tax should be the same for all types of insurer, whether joint stock, Lloyds, mutual or reciprocal.

"The premium taxes of the Special War Revenue Act of the Dominion should be returned to the form in which these premium taxes were found in the Provincial system of tax upon insurance corporations before these sources of revenue were surrendered to the Dominion, i.e. - a non-discriminatory rate. The new rate of Dominion tax of 4% for premium deposit mutuals, substituted in 1942 for the former Provincial taxes (which had always been on a non-discriminatory basis) was enacted notwithstanding the protest of the factory mutuals addressed to the Minister of Finance and without any statement in justification thereof by the Minister. We respectfully urge this Commission to recommend return to the principles and methods of the provincial governments in relation to this source of revenue, which principles continue to be applied by the Dominion to the business of life-insurance.

#### XVI - CONCLUSION

"The factory mutuals therefore respectfully submit that the Royal Commission on Co-operatives should find and recommend the following conclusions:

"(a) That the facts regarding underwriting profit, liable or exempt from income and excess profits tax, have been misrepresented to the public by the Dominion Insurance Blue



Book, and published statements based thereon, in so far as the deposit premium mutuals are concerned;

"(b) That application to deposit premium mutuals (the factory mutual companies) of the present income tax and excess profits tax regulations would show no taxable underwriting profit or gain whatever on their operations, when investment income is excluded from the account, as is done in the case of British and foreign joint stock companies;

"(c) That there is and can be no underwriting profit subject to tax, as such, in the hands of the factory mutual companies, since all savings and unabsorbed premium deposits are returned to or held for the account of policyholders and enter into the income accounts of the policyholder of the mutual company under the Income War Tax Act and Excess Profits Tax Act;

"(d) That the income tax and excess profits taxes paid by joint stock insurers are charged to shareholders account, and are only the same proportion of the shareholders profits as that of any other Canadian business; that these taxes on joint stock insurers do not directly affect premium rate levels charged to policyholders and are not an element in competitive premium rates of the various types of insurer; that the indirect effect of such taxes is to reduce premium rate levels charged by joint stock insurance companies by stimulating competition in premium rate.

"(e) That the factory mutual companies (and other companies operating on the deposit premium plan) are subject to an unfairly discriminatory premium tax under the present provisions of the Special War Revenue Act, whereby net taxable premiums of such companies are subject to a rate of 4% tax while other mutuals pay a tax at the rate of 3% and joint stock companies a tax at the rate of only 2% of net premiums;





"(f) That the premium tax at present applied by the Special War Revenue Act to the deposit premium insurers is in its nature, if not in name, a tax on gross income from investments. It is unfairly discriminatory as against premium deposit insurers (the factory mutual companies) by reason of the fact that it includes in the computation of net taxable premiums, investment income on the unabsorbed premium deposit for Canadian account, while no other type of insurer is required to include in taxable premiums any item whatever from investment income account and no interest charge on premiums in the hands of the insurer; that ~~this~~ discrepancy has the effect of increasing the actual amount of the premium tax payable by the factory mutual companies by at least one-third;

"(g) That the same investment income of premium deposit mutuals is subject to income and excess profits tax in the hands of the policyholder to whom it is returned as an element of his unabsorbed premium deposit;

"(h) That it is desirable and equitable that the unfairly discriminatory aspects of the present premium tax applicable to factory mutual companies be removed;

"(i) That if the Minister of Finance requires a larger contribution to public revenue from the fire insurance business as it is conducted in Canada, the most equitable form of such increase lies in the adjustment of the premium tax rate or level according to the principles on which that tax is now applied to the life insurance business in Canada, that is to say, a fixed and uniform percentage of the net premium for all types of insurer, computed according to formulas appropriate to the type of insurer affected and equivalent in all cases to the net premium paid for such insurance by policyholders.

"RESPECTFULLY SUBMITTED on behalf of the Canadian Members of the Factory Mutual Fire Insurance Companies.





MR. HOVEY T. FREEMAN,

President, Manufacturers  
Mutual Fire Insurance Company,  
having been duly sworn,  
testified as follows:

BY MR. GRAY:

Q. Mr. Freeman, the briefs which have been filed with the Commission bear your name. What have you to say as to your part or responsibility for them? A. I of course helped Mr. Gray in the preparation of these briefs. I think they tell the story very completely. I do not want to burden you gentlemen with a further explanation thereof. I want to again state that I concur in everything Mr. Gray said about the position of our companies; that we want to pay our share of taxes. We feel that we are paying our share now. We feel that there is a discrimination against us, but it has not hurt us particularly, so we have not opposed it before. But if it is additional revenue you are looking for, and I believe it is, then I think you will have to find it elsewhere rather than from us.

This same problem of the taxation of mutual insurance companies has come up in the United States Congress for many years. I have appeared before the various committees of the United States Congress, and also followed for many years what was done there. Congress repeatedly, year after year after year, decided in their wisdom that mutual insurance companies such as ours did not have taxable profits; and therefore the records will show that all of the acts of Congress, starting in 1913 right down through the acts of 1914, 1915, 1916, 1917, 1918, 1919, 1920, 1921, 1922, 1923 and 1924, all the years when there were acts of taxation, exempted mutual insurance companies such as ours from taxes, because income tax is a



tax on profits. Mutual fire insurance companies have no profits as such. There are only a few ways that our funds can be used. A member pays in a deposit. That is not the rate. That does not represent the net cost of insurance at all. It is purely a deposit out of which the net cost or true premium is taken at the termination of the policy.

Now let me explain just how that is worked out. We close our books each month. We have what we call a computation book. We figure the loss expenses for the month, and the other expenses, and the taxes and so on. Then we credit the income from investments, and then we determine a charge against the average net premium in force. Those monthly charges vary, of course, depending on losses and expenses. If a man's policy runs for a period of twelve months, he has a summation made of those twelve monthly charges. That represents the absorbed premium.

As Mr. Gray stated, the deposit premium is the same for all terms. It makes no difference if a man takes coverage for one month or five years, but most of the policies are for three years. The absorption at any time is simply a summation of those monthly charges. Of course it goes almost without saying that we do not always turn back to the policy holder the full amount of the unabsorbed premium deposit. We keep a minor portion for a reserve for bad years, the unusual loss that comes along once in a while. Those monthly additions to reserve, however, are a very minor matter. At one time Congress in the United States thought that might represent and be a measure of a form of profit, but that was given up as being unworkable and erroneous.

The necessity of these monthly credits to the reserve is due to the fact, of course, that losses do not remain the same





every year. You get these big peaks, as shown by these charts, where we have a year of very bad losses, the most recent one being the bad hurricane in 1938, when we had very heavy losses. Fortunately, as the result of having put something aside during the good going, we were able to take from reserves during that bad year, and in that way were able to keep the cost of insurance to the policy holder at the same figure. In other words, if it had not been for reserves we might have had to reduce our dividend say ten points, from 90 per cent to 80 per cent. Instead of that, in my own company, for instance, I was able to take and pay back practically \$1,000,000 out of reserves from prior years, and use it for paying hurricane losses.

The reason I am bringing that out is that even these monthly credits to reserve can ultimately be paid back to the policy holder if we have a period of bad losses. Our by-laws and our charter provide where the money shall go in case of liquidation, so the money finally, in the last analysis, has to go back to the policy holder. It can go nowhere else.

I could go on endlessly with the story of factory mutual insurance, but I think perhaps rather than do that you would rather ask me definite questions.

Q. Thank you. May I ask you this? Would you tell me shortly how it happened and why your companies came to Canada, and when I say "came to Canada" I mean undertook to accept Canadian risks? A. Well, I would answer that with the story of something good; that where there is something good, it gets around. The Canadian manufacturers apparently heard of the excellent job we were doing for manufacturers in the United States, and they requested our services. They came to us in Providence and Boston and asked us to cover their risks



up here, which we did. We started with no insurance in force at all, of course, and to-day the total of Canadian risks, throughout Canada, for the system as a whole, would be almost a billion dollars, so we are growing at a very nice rate.

Q. So far as Canadian industry was concerned, was your beginning associated with any particular industry or for any particular purposes? A. We started in business in 1835, as a result of the textile manufacturers in New England feeling that they were not getting a proper recognition from the stock companies for the improvements they had made in their factories. So at that time the original incorporators took the rate of the Aetna Insurance Company, the prominent stock fire insurance company of the time, and they adopted for the textiles 75 per cent of that rate. At the end of the first year we returned 51 per cent, so that 51 per cent of the 75 per cent, plus 25 per cent, if my mathematics are correct, amounts to a saving of about 62 per cent of the cost that these plants had formerly paid. So it was clearly demonstrated that they had been paying too much; and since that time, right down through the century, we have always paid a very substantial dividend to policy holders.

Then, going on, of course other classes heard of what we had done for the textile class, so demands for our services kept increasing. To-day 44 per cent of our business is in the metal-working class, and now only 15 per cent is in the textile class, which used to be 100 per cent. The paper class is about 6 per cent and the food class about 4 per cent; then other manufacturing classes are mostly small. We have earth products, chemical products, soap factories, tobacco factories, leather works and so on, which account for another 24 per cent.





Then we have a very small group of non-manufacturing risks such as hospitals, schools and so on. You may wonder why we, as industrial insurers, got into such properties as these. The explanation is very easy to give. The trustees of large corporations are also the trustees of hospitals and charitable organizations. They have also requested our services, with the result that to-day about 6 per cent of our total business is in what might be termed non-manufacturing risks. That percentage is mostly in that sort of policy. It is not a type of business we solicit.

Q. What about Canada? Would there be much of that classification in Canada? A. No, I do not think we have much of that here.

Q. Then would you say whether the existence in Canada of factories and enterprises associated with United States business has been responsible for bringing you into Canada, in any important degree? A. Yes. I could not give you the exact figure, but I am guessing that probably 60 per cent of our Canadian business comes from purely Canadian concerns and 40 per cent comes from Canadian branches of United States parent concerns. Is that what you mean?

Q. Yes, thank you. Then there was some little discussion a few minutes ago about the joint inspection service for the companies, through the Boston office. Is there anything you would like to add about that, to what has been said? A. That goes into quite a number of other subjects. It really involves the reason why we started business. The type of manufacturer or individual that we insure is the type who does not want to have a loss. He wants to be shown how not to have a loss. As a result of that, we have developed, we believe, the finest inspection service in the world; all





trained engineers, most of them graduates of technical schools. They have been able, as a result of over a century of experience, to point out where hazards exist; and to eliminate those hazards. To-day we are spending close to a million and a half dollars a year in purely preventive work in our inspection department, as the result of periodic inspections. If a plant does not maintain its facilities in accordance with our standards, then we simply ask them to please place their insurance elsewhere; but there are very few cases of that. The manufacturer does want to be free from losses, so he does carry out our recommendations.

Q. That leads me to ask you about the turnover in your membership. Is there a continuity to the membership in your companies which is notable or differs in any way from other businesses? A. I would answer that by saying there is almost no turnover. On the other hand each year we increase the number of risks we have in Canada and in the United States. Then there are other reasons for that, too, because not only is our primary interest the prevention of loss, but we serve only our policy holders. We have no agents, no brokers whose interests have to be taken care of. We have no stockholders who naturally, of course, would be entitled to look for a profit. So we are the representative of the assured. We therefore can give and have given, and have been leaders in providing, broad policy coverage, the broadest obtainable. I will have to admit that after we lead, others follow. Sometimes it takes them two weeks and sometimes four to six years, but they generally come along.

Then there is another factor as to why we have no turnover. That is our loss adjustments. There are many



gentlemen of legal talent here, and of course this does not help the legal profession, but we do not have lawsuits for losses. We have never been taken into court, in over 100 years, in the settlement of a claim. No other organization in the world can point to that record. We are representing the policy holder. Of course that is not good business for the lawyers.

BY THE CHAIRMAN:

Q. Are you recommending that to the Canadian Bar?

A. It would be rather tough on them, I am afraid. I just want to point out again that the policy holder does come first. He is our only interest; and if we do something the policy holder does not like I, as company president, hear about it. But we do not do those things.

Another reason a member stays with us and comes to us in the first place is low cost. We do business at cost, and naturally that attracts him. Does that answer your question?

BY MR. GRAY:

Q. I think so, thank you. Mr. Chairman, there may be some questions which you and members of the Commission would like to ask Mr. Freeman now?

BY MR. VAUGHAN:

Q. Why is the premium charged ten times the cost?

A. I do not wonder that you ask that. That seems like a very large sum, but it also makes for absolutely safe insurance for the policy holder. We are insuring very large risks. We have no capital, with the result that our deposit premium sets up a very large sum so that if things should go wrong we have the money in our hands. We have been in business for 109 years, and we have never had to make an assessment. We have the right to assess up to five times our premium deposit.





BY THE CHAIRMAN:

Q. Would you call the deposit your capital? A. I would not call it the capital. I would say it takes the place of capital, but it is not the capital. As a matter of fact we are reducing the size of this deposit. In the last twenty years I would guess that the average rate has come down from 75 cents to an average now of about 51 cents. We do not need this large sum, and our whole plan now, as a result of the improvements in construction and in fire protection, is to reduce this big advance premium and then pay back a smaller return. It seems foolish, as Commissioner Vaughan suggested -- it may seem foolish to some of you that we should collect such a large sum and then pay back 90 per cent; but it is also very safe practice for the policy holder, and he does not object.

BY MR. VAUGHAN:

Q. One other question. It has been mentioned that there are fire mutuals in England. Do you know how they are taxed in England? A. I am sorry, sir; I do not.

BY MR. ELLIOTT:

Q. With regard to the deposit premiums, you say that to some extent they take the place of capital for you. Those funds are invested by your company? A. Of course; yes, sir.

Q. And the income from investments diminishes the amount of net deposit to the policy holder? A. That is correct; that is, that income is applied against the losses and expenses. I can show that by a chart, if you would like to see it, but I have not enough copies to pass around.

Q. I think I understand the principle. A. You are welcome to have this chart if you wish it.

Q. An increase in the return that you are able to get on your investments will, therefore, decrease the net cost of



insurance to your policy holder? A. That is true, yes, sir; that is ultimately reflected.

Q. Or an increase in the size of the premium deposits which you require, if no other change took place, would also diminish the net cost of insurance? A. On the theory that we would have more money to invest, and therefore more interest?

Q. Yes. A. That is true; but the tendency is the other way.

Q. Why is the tendency the other way? A. Because there has been a tremendous improvement in construction. We are having more concrete, so-called fireproof construction today than before, and the danger of a total loss to a member is less.

Q. You feel that you do not need such large sums on deposit? A. That is correct.

Q. Your policy holders presumably could use these funds themselves, if they did not have to deposit them with you?

A. They could. They come out of their working funds, so presumably they could use them themselves. That is true.

Q. So that part of the burden which your policy holders have to bear arises from the fact that they have to keep this deposit with you? A. That is a burden and not a burden, because he gets the benefit of the interest on it, just as if he held it himself. It acts to lower the cost of his insurance; and by reducing it, it thereby increases his profits, which are taxable.

Q. But if he invested it himself, then he would have to pay you a greater net premium? A. Certainly, if we did not have the money; but that question of interest very seldom comes up.

Q. I think I understand you there. Is the expectation



of unusual losses, or your estimate of the danger of unusual losses, the only factor that you take into account in deciding the general average size of these deposits; that is to say, whether they will be ten times or eight times or twelve times the amount you expect to pay back? A. Certainly if we did not write such large risks, where the possibility of loss exists, we would not need such large deposits. There is another factor there, too. If there were reinsurance available in bigger amounts than is available to us, then we could reinsure to take care of ourselves in the event of catastrophic losses. However, practically the only market we have for that is London Lloyds, because the people in the joint stock companies do not want to reinsure the factory mutuals. But I think that is going to be changed, as the result of a recent decision.

Q. That is one matter in deciding the average size of the premium deposit? A. Yes, it is.





BY MR. ARNASON:

Q. Mr. Freeman, I understood you to say that you consider the deposits by your members to be in a different category from the capital in an ordinary company. Is your reason for that opinion based partly on the difference between your deposits as compared with share investment capital in an ordinary company, which is not withdrawable? I wondered whether that was one of the reasons.

A. I would not say the two sums are comparable. Ours is purely an advance of a sum of money out of which the premium is taken. On the old theory that a bird in the hand is worth two in the bush, it is much better to have your money with the insuring company rather than in the hands of the policyholder, where you might get it or might not get it in the case of an assessment.

BY MR. GRAY:

Q. Will you just go on to answer Commissioner Arnason's question by comparing it with the capital of a joint stock company gathered from the stockholders? I think the Commissioner would like to hear something more from you about that, so would you point out the similarities or differences between the two funds?

A. There is a tremendous difference there. In one case the capital fund is put in by a totally different group of persons than policyholders, a group of stockholders, whose interests are not at all the same as the interests of the policyholders. That is, a deposit premium is the policyholder's money, goes back to him, is used for his own purposes, nobody else's. The capital stock comes from stockholders, probably 99 per cent of whom are not



also policyholders, and their interest is very different from that of policyholders. I would say that in the case of a stock fire company the policyholder comes third. The reason I say that is this: the reason a stock fire company is organized is to make profit for the stockholders, so the stockholders' interest comes first; then the agents and brokers get their income as a percentage or commission on the rate charge--the higher the rate the larger the commission; also, the higher the rate of commission the more profitable to the agent or broker it is. So the last fellow to get consideration in a stock fire company is the policyholder; but he is the only one we have to deal with.

Q. Now as regards that withdrawal feature to which the Commissioner refers, would you compare the premium deposit of the factory mutual member with the stock company subscriptions to a premium capital fund, so far as the administration of the company is concerned? Just contrast your company attitude towards this deposit premium with the company attitude towards a stockholder's subscription, if you can? A. I am afraid I can't answer that very well, Mr. Gray, because I have never run a stock company and do not know what their attitude is towards their stockholders. I know that, as I said here repeatedly, as regards our deposit premium, we have just one interest to serve, that is the policyholder.

Q. One is withdrawable, though. I think that is the point the Commissioner was expecting you to make. A. The policyholder can cancel his policy at any time and get back his unabsorbed part of the premium deposit from us. It is true that during the last depression one or two very





large concerns found themselves temporarily sailing pretty close to the wind, to put it mildly, and they asked for a return of their deposits and temporarily took out insurance in the stock fire companies, where they had to put up less money.

That served as an anchor to windward for them. That is one reason why we carry such a large part of our funds in short-term Government bonds, to be ready at any time to pay back any sum required; and those sums are payable back at almost a moment's notice.

BY MR. NADEAU:

Q. When one of your insured cancels his policy he is entitled to get back his unabsorbed premium, but prior to that he has contributed to your reserve fund? A. That is correct, and he cannot get back the accumulations that have been made to reserve while he was a member. All he gets back is the unabsorbed premium deposit of existing premiums that are in force; but if we should liquidate, the money goes to him and to any member who has been a policyholder in the last six years.

Q. But inasmuch as he has contributed to part of your reserve fund and inasmuch as he does not get that part back, is there not an element of profit for your company?

A. Well, I cannot deny that it stays with the company, but it stays for the policyholders who remain insured by the company, it remains there for their benefit. True, if a policyholder leaves it remains with the company, but we do not have many people leave, so that is not a very important question. Our turnover is very small, so far as people leaving us is concerned.

Q. Would it be possible to have figures of that reserve built up by policyholders who have discontinued



with your company? A. It could be estimated. It would be a rather difficult job. I know the figure runs between  $1\frac{1}{2}$  and 2 per cent of the original deposit premiums per year. That is about what we figure it. It is a small sum in total. It was that sum that the Congress in the United States was attempting to tax us on at one time but gave up because they saw difficulties in attempting to do it, and therefore when the war started they adopted this other measure which I expect Mr. Gray or somebody else is going to explain later.

BY MR. GRAY:

Q. Taking a forty-year period, since the beginning of the century, could you give the Commissioner any idea, by illustrating from your diagram, what actually happens with regard to these reserves or surpluses, and then measure if you can or estimate over a considerable period, say over a forty-year period, what is the result to the company?

A. Mr. Gray, I don't believe I could do that, because there are other factors involved in these reserves. Against these reserves we charge our losses on investments, and unfortunately every once in a while we make a bad investment. So the reserve is not entirely a build-up from the policyholders; it also comes from profits. We make money on investments and that goes into the reserve. Also the reserve is used from time to time in the event of hurricanes and very bad losses. At the present time we have assets of about 140 per cent of our premium deposits in force, but I could not say how much of that came from the members and how much came as a result of investment transactions; I have not any knowledge of that.





Q. Let me put it this way. Suppose you were a Commissioner--but we do not need to invent a Commissioner, for there are five, so let us rather suppose that the Commissioners were wanting to know what revenue might be obtained for the Treasury by assessing for income tax the actual surpluses of your companies. A. You mean the annual contribution to surplus?

Q. Yes, the annual contribution to surplus. Would that constitute a substantial source of revenue from your companies? A. No. It would be less than two per cent of the premium deposits written for the year and taxed at whatever the taxes happened to be.

Q. Suppose it was 40 per cent. Forty per cent of two per cent would be how much? A. I haven't any figures of it. I could go through some mental gymnastics and develop a figure, but I would have to check it after.

Q. I just wanted you to tell anything that you could off-hand, but of course only in so far as you feel confident as to any answer that you make. A. I think we worked that figure out in the brief somewhere. I haven't it with me, but I know it is a very small figure.

Q. I wonder if you have the figures that you gave to the Congressional Committee in regard to that matter. I thought I had them here with my material, but I have searched for them without success.

MR. GRAY: I wonder if I could ask the Chairman for leave to file the statement made by Mr. Freeman to the Committee on Ways and Means of the House of Representatives in relation to this particular matter of the accumulation of reserves from operating surpluses over the years? I have a copy of the printed report of the Committee on Ways





and Means, and it deals with the evidence supplied by Mr. Freeman to the Committee. If I may have leave to file a copy of the evidence and give my friends a copy--

MR. ELLIOTT: That is the 1942 report of the Committee of the House of Representatives?

MR. GRAY: Yes, Mr. Commissioner.

MR. ELLIOTT: You might check it with the Registrar. We have a copy of the report, but we have not a copy of the evidence.

MR. GRAY: It is the evidence that I am referring to.

BY MR. GRAY:

Q. Do you remember to what I refer? A. Yes. That was a special brief. I haven't that with me. I can say it would be a very disappointing figure for tax purposes, that you won't get the money you are looking for.

BY MR. ARNASON:

Q. Mr. Freeman, in connection with your reference to 2 per cent of premium deposits-- A. It is really 2 per cent of the premiums written during the year.

Q. Written during the year? A. Yes. You see, most of the policies being written for three years, that brings in a complication there. I wouldn't want to guess at that figure, what it would be, but I know it is 2 per cent of the annual Canadian net written premiums.

Q. That is, 2 per cent of the total amount deposited?

MR. GRAY: No, Mr. Commissioner.

MR. MINN: He said that before.

THE WITNESS: It would be a very small sum.

BY MR. GRAY:

Q. Would you just make clear for the record that distinction between 2 per cent of the premium deposits



in force and 2 per cent of the written premiums for the year? To which did you intend to refer? A. I was wrong just then. I should have said of the in-force business. It would be 2 per cent of the premium deposits in force. I have here my directors' report that I submitted to my directors' meeting last week, and some of my competitors here would be glad to see these figures. Actually on one year's policies my office, our company, earned 93.49 per cent. We returned 92 per cent. That is 1.49 one-hundredths of one per cent of the premium deposits in force. On three-year policies we earned 77.60 per cent and returned 74 per cent. That is a setting aside to reserve of 3.6 per cent.

BY MR. NADEAU:

Q. What are the rights of your policyholders to your surplus assets over liabilities? A. They can only be used to pay losses and expenses on liquidation of the company. The policyholder cannot get back any reserve he has contributed unless the company is liquidated, or unless it is paid back to him in the form of losses and expenses.

BY MR. VAUGHAN:

Q. Is there anything to indicate your total reserve in relation to total risk, say in this past year as compared with some five, ten or twenty years back?

A. The figure goes up and down, sir, because of the ups and downs in the security market. If we have a depression like 1932, with very low market values for securities, that naturally affects our total assets. Our premiums are not affected except by inventory and so forth. The reserve during depression years would





be smaller. At the present time as a result of boom conditions everywhere and the stock market having improved materially over 1932, naturally our reserve is very much larger now than it was then.

Q. How would it be in relation to your risk? A. I haven't these figures with me, but I would say that at the depth of the depression the companies as a whole had assets of about \$56,000,000 and premium deposits of about \$50,000,000 at that time. At the present time I think our assets are very close to \$100,000,000 and our premium deposits are in the neighbourhood of \$80,000,000 or \$81,000,000, somewhere in there.

Q. That is, your reserves are much larger in proportion to your risks now? A. At the present time. But they have come from appreciation in the market value of securities and not from earnings taken from the policyholders.

Q. Is not that a very large reserve, when you consider that two-thirds of your risks are not going to go in one year? A. It is a large reserve, no question about that; but it gives safety, and our primary interest is in being able to pay a loss if a bad loss comes along.

Q. But you could never have a loss in proportion to this reserve? A. We hope that, we hope you are right. I may say we have carried and collected from our friends at London on catastrophe insurance policies. As a matter of fact, after the 1938 hurricane as a result of a contract with I had with London Lloyds, Lloyds paid us I think it was three and a half million dollars, and we had only paid into their pot I think three hundred thousand dollars, so it was a very nice transaction. They paid us about ten to



one. Of course they immediately raised the rates afterwards on renewal, but that is another matter.

Q. The cost of insurance is varied largely by the interest on your investment? A. The interest on our investments, as that chart shows, just about covers the expenses. It did when interest rates were higher, with the result that the only amount that had to be taken from the deposit premiums was the losses. That is, roughly speaking. Nowadays with low interest rates, it is not quite the same, because instead of earning about 5 and  $5\frac{1}{2}$  per cent our investments are earning  $3\frac{1}{3}$  or  $3\frac{1}{2}$  per cent over all.

Q. Do you think your company is largely an investment company rather than an insurance company? A. Some people try to claim that we are carrying on an investment company, but of course that is not so. We are ultra conservative.

BY MR. NADEAU:

Q. Do you make any surplus or profit on your reinsurance business? A. We confine our reinsurance to the other companies in the system. There would be no profit on that, sir, no. We have a few policies for other companies, but it is a drop in the bucket, so there is no profit comes to us as a result of reinsurance operations.

BY MR. GRAY:

Q. In that connection, would you just explain to the Commission how you divide the risk? Suppose you have a risk of \$200,000,000 offered and the Manufacturers is the placing company, and that your limit of retention is \$50,000,000. What happens with regard to the insurance of the other \$150,000,000? A. Formerly, up



till about five years ago, we issued individual contracts, each participating company sent to the assured its own policy contract for its participation. A risk of that size would be divided among all the companies in the system. The assured, however, did not like having so many separate contracts, he wanted one contract, so now the so-called placing company is the company that handles the risk for the association, issues its policy for the entire amount, and then reinsures with other companies in the system their participation. In this risk that Mr. Gray speaks of, \$200,000,000, we would retain \$50,000,000 and reinsure \$150,000,000 in the other ten companies, and when the policy terminated the other companies would return to us their unabsorbed premium deposits. We add these together with our unabsorbed deposit and return it to the assured, or credit it to the new premium deposit called for by his new policy.

Q. Am I right in saying that on the \$150,000,000 the placing company receives no profit for itself, but actually returns to the insured precisely what it receives from the associated companies? A. That is substantially correct. I say "substantially", because there is some benefit in reinsuring, because of the difference in the amount we earn and the amount we pay as a dividend. That comes in there and complicates the picture a little bit, but it is a minor matter.

BY MR. ELLIOTT:

Q. The amount that you receive back from the reinsurers is not credited directly to the account of the individual policyholder whose risk you have reinsured? A. Yes, it is. Take the XYZ Manufacturing





Company. We distribute that among eleven companies: one company will have 10 per cent, another small company might have only 3 per cent, another big company might have 40 per cent, and so on. When that policy terminates and the return of the unabsorbed premium deposit is made, that comes back to the placing company.

Q. Does it go back to the XYZ Manufacturing Company?

A. Yes. But instead of sending to the XYZ Manufacturing Company eleven separate cheques, we send one cheque, which is a consolidation of the returns from the eleven companies.

Q. And that is exactly the sum of the eleven returns?

A. That is correct.

MR. GRAY: That is the point, Mr. Commissioner.

THE CHAIRMAN: Mr. Parker, have you any questions?

MR. PARKER: Yes, Mr. Chairman.

BY MR. PARKER:

Q. Mr. Freeman, my purpose is only to try to clarify the position which your people take before this Commission, so that we may properly understand your contentions. To begin with, will you please tell me on whose behalf this submission was made that you are supporting here to-day?

A. I have two jobs here. I am President of the Manufacturers Mutual Fire Insurance Company, of Providence. I am Chairman of the Legal Committee of the Associated Factory Mutual Fire Insurance Companies. The companies get together once a month--

Q. I will come to that later. You are to-day in a dual capacity, representing these two groups? A. I am representing my company and the group as a whole.

Q. There is an expression here, "The Associated Factory Mutual Fire Insurance Companies." In what way



are they associated? A. It is purely a voluntary association of the eleven companies. The eleven company presidents meet once a month. We have long discussions; we don't always agree, but we finally come to an agreement, and we appoint subcommittees to what we call the Joint Affairs Committee.

Q. Subcommittees of your presidents' committee?

A. Yes. The presidents' committee is called the Joint Affairs Committee.

Q. You need not go into details. That is a voluntary coming together of the eleven presidents? A. That is correct.

Q. That is all the association means? A. Yes. We do operate an inspection department out of joint funds.

Q. First I want to get your organization, and then we shall find out what you do afterwards. Have you a president of that committee of eleven, or a chairman or chief officer? A. We do, but that office rotates each meeting.

Q. But you have one, at all events? A. When the committee meets in my office I am the president.

Q. Just for the meeting? A. Yes. We have a permanent secretary.

Q. Does this association--we will call it an association--operate an office, have a permanent secretariat? A. No. The secretary of the Joint Affairs Committee is the manager of our inspection department. He simply keeps the records of what we do.

Q. You were asked to come here and make this submission on behalf of the eleven in your association?





A. Yes. But I am not a lawyer, if that is what you are driving at. There is so much legal talent here, that I want to make that clear. I am just a company official.

Q. What I want to know is, have you instructions from these other ten companies besides the one of which you are the president, the Manufacturers, to submit arguments along these lines--I do not mean in every word--but along the lines you have taken to-day? You have discussed this with the group? A. Yes, that is correct. They have seen copies of these briefs, or one or two have; the other presidents do not care anything about the legal end.

Q. Do they care anything about the taxation end?

A. Very much.

Q. Did they instruct you, and have you authority to say here to-day that you are representing the views of these eleven companies on this question of taxation?

A. That is correct.

Q. A good many questions were asked you by members of the Commission concerning these moneys that are in the custody of the companies, sometimes called reserves or the balance of the deposit premiums--I do not care what you call them. Does what you have said in reference to these apply with equal force to all the eleven companies?

A. We all operate on the same basis, yes, sir.

Q. See if I can state what that position is. To begin with, a member of any company is merely one person who has insurance in that company. That is the only qualification he has to be a member? Once he gets insurance, he is a member, is that it? A. He is



automatically a member, yes, sir.

Q. That is the only qualification? An insured company or individual is a member of the company? A. He is a member, yes, sir.

Q. And no person else excepting one who has a policy of insurance is a member of the company? A. That is correct.

Q. Is there any membership fee required from an insured in addition to the amount he pays as his premium deposit? A. No, sir.

Q. Not a cent? A. No, sir.

Q. So the entire source from which these companies get money, apart from investment income, which I shall come to in a moment, is these premium deposits? A. That is correct.

Q. Will you please tell me how a newcomer would go about becoming a member of any one of these companies? Suppose I came along, as the owner of a factory, and said I had heard about you and sought admission. A. Of course, I hope you would come to me and not to any one of the other ten companies.

Q. I do not know whether I would; that would depend on what your reputation was. But let us assume I came to you. A. Thank you; I will keep that in mind.

Q. Will you tell us what your procedure would be? A. We do practically no national advertising, so the only way we would get a policyholder or an insured would be that he probably heard about us through some other member.

Q. Let us say that I have heard about you and I am now at your door. Start from there on. A. We do not say, Mr. Parker, that we will insure you to-day or as of



noon at such and such a date. If it were in Canada I would send my good associate, Mr. Costigan, around. He would make a preliminary survey of your buildings.

Q. And of me too, I suppose? A. Yes, he would size you up. I think you would pass. Then if it was a large risk where he felt that he wanted the advice of experts, he would call on our inspection department. If it was a chemical plant he would probably call on one of our chemical engineers; if it was a public utility plant, he would probably call on an electrical engineer.

Q. In any event, he would make a very thorough investigation? A. Yes. That investigation then goes to the home office of the placing company.

Q. The home office of the placing company? A. That is correct.

Q. I am at your office, at the office of the president of the Manufacturers. A. I was trying to make the distinction that if you came into our Toronto office, where Mr. Costigan is, that he could not tell you off-hand, could not make the decision. He would ask Providence, the home office, for approval.

Q. Let us assume that I have finally been approved. What do I do then? Do I then make an application for membership? A. No. Either by letter or telephone or personal visit you would say, "I would like you to take a risk--let us say of \$1,000,000--on my property." We would say, "Yes, sir."

Q. Can we not go over this with fewer words? Assume that I have been investigated and approved as a member. Do I then make an application for a policy, that is after I am notified that I am acceptable, or is





Q. A policy simply issued to me? A. The policy is issued, there is no formal application.

Q. Are the policies of your eleven companies identical in terms? A. Yes.

Q. That is, the conditions are all the same? A. Yes.

Q. Do your Canadian policies have any statutory conditions printed on them? A. We use the Quebec or Ontario form, if that is what you mean.

Q. As the case may be? Have you a copy of your policy here, the Quebec form? A. I have copies of policies, but whether I brought with me a Quebec policy I do not know.

MR. GRAY: I have one.

MR. PARKER: I do not ask for one now.

BY MR. PARKER:

Q. We have this, then, that no application form is required, but the policy is issued and the premium deposit is made? A. That is correct.

Q. You have now acquired a new member and that new member has acquired insurance and he has paid a deposit of a certain amount. Will you tell me how you arrive at the amount of the deposit you are going to require from me, say, as a new member? First, who decides it; and secondly, what are the main factors that are taken into consideration affecting the amount of the premium?

A. Over the years as a result of the experience that has been accumulating we have built up a so-called schedule of gross premium deposit rates for different classes of risks. Those rates run from about a minimum deposit of I think 32 cents for the average risk to it might be as high as 80 cents, except for



pulp wood piles, and that rate would go maybe to \$2.

Q. It is classified? A. Yes, according to the hazard, the expected loss.

Q. Is that the main element, the anticipated loss hazard? A. Yes. We have what we call a basic rate committee. They take the experience of the companies over the years. Because of the nature of our business we have to take a long period of years, because we have very few total losses.

Q. I do not want the whole history of what you do, but just an outline of the factors that are taken into consideration. You say you take into consideration your experience and the nature of the hazard. What else?

A. I think the member in our organization comes the closest to paying the actual cost for carrying his type of risk that he does in any insurance organization in the world.

Q. Is that an answer to the question I asked you?

A. I thought that was what you were getting at, the class paying for its own risks.

THE CHAIRMAN: Did Mr. Freeman say he was not a lawyer?

THE WITNESS: I have been associated with them.

BY MR. PARKER:

Q. My question was clear, I think. I merely asked you to enumerate, if you would, the main elements that are taken into consideration in fixing the amount of that deposit premium that I, as a newcomer, would have to put up. You have told me two: the nature of the hazard as reported to you by your inspection service; and, secondly, your experience over the past in losses on that type of risk. What other factors are taken into consideration? A. The





expenses of carrying on the business as a whole.

Q. That is three factors. Any other? A. Taxes would come in there.

Q. I am coming to that. A. It is an item of expense.

Q. That is calculated as part of the cost? A. Yes.

Q. What kind of taxes do you include in that?

A. All kinds.

Q. Let us get that straight. Is it all taxes which the company may then be paying or may reasonably anticipate to have to pay? A. That is correct.

Q. Would you include in that the incidence of income tax such as we have in Canada? A. We would have to.

Q. You would think that would be a very important element in fixing the amount of this premium, would you?

A. It is a part of the cost, but I do not agree with your expression that it is a very important element.

Q. It is important according to size. I think you said a while ago that you did not know much about joint stock companies? A. I am trying to learn.

Q. Was I right in saying that you did not know much about their operations? A. That is what I said, yes.

Q. Do you know this much about them, do you know the elements that are taken into consideration by them in fixing their premiums? A. I would rather that would come from an expert from a stock company, but I would answer it this way--

Q. Do you know? If you do not know, say so.

A. I do not know as of personal knowledge, no.

Q. Do you know whether in their rate making they take into consideration the incidence of income tax on



their companies? A. I am told they do not.

Q. Do you agree that it is a proper factor to be taken into consideration? A. That has come to me from what I consider an excellent source, that they do not.

Q. Do you know enough about it to express an opinion as to whether it is an element in the cost of insurance in a joint stock company? A. Their system is entirely different from ours, sir.

Q. I realize that, but they have to fix a rate by taking some things into consideration. I suppose the nature of the hazard must be one of them, the same as with the mutuals. A. The fact that they do not include it in their premium rate computations must mean that they get it from some other source. It has to be paid.

Q. I do not know that I quite get the import of that.

BY MR. ELLIOTT:

Q. Are you discussing the determination of the amount of the premium deposit? A. I understood that counsel asked about joint stock companies.

BY MR. PARKER:

Q. There is no question it is a factor in the mutual companies? A. No question about it at all.

Q. I merely asked you by way of comparison if you know whether or not it is a factor which is taken into account by the joint stock companies in the fixing of their premiums. A. I say that it is not.

Q. You believe you have been correctly informed that it is not taken into consideration? A. That is correct.

Q. And I asked you if you would express an opinion



as to whether you feel it really should be. A. I have never run a stock company, so I do not know.

BY MR. ELLIOTT:

Q. You say that in determining the premium deposit rates of your company, income taxes are taken into account as an expense? A. All items have to go into the expense make-up, yes, sir.

Q. That is in determining the deposit premium payments, the original deposit premiums? A. That is correct. That is an item in the build-up of the rate.

Q. The different companies in your association make different rates of income in the same year as that is computed for income tax purposes in the United States?

A. There would be a slight variation, because some companies invest practically only in Government bonds, and others, like ours, invest to a very large extent in common stocks and have done very well--our rate of return on our investment is quite a lot higher than that of some of the other companies in the association.

Q. But the reverse might have been true in 1932?

A. That could have been, but we were not hurt, we came through all right.

Q. On what companies' income tax do you base the factor of the income tax expense? A. You see, sir, we have the advantage that under our system any item of expense that occurs during the life of the policy goes automatically into the absorbed premium.

Q. I am not asking about the absorbed premium, I am asking about the initial deposit premium.

MR. GRAY: The basic rate.





BY MR. ELLIOTT:

Q. The whole amount that you ask your member to deposit with you? A. You cannot answer it just that way, sir. Maybe I can state it this way: it makes really no difference what our original deposit is.

Q. For my purpose on this point it does. A. I am afraid I don't follow you there, because it all comes out on the basis of the returned premium.

Q. I know that the remainder is returned to the member and that any taxes you pay cannot be returned to him. The question is, in determining the rates of premium deposits required initially from your members, how exactly is the income tax that your companies pay taken into account, how does it affect the total premium deposit initially required? A. That is difficult to answer. We have simply a record of all the items of expense. We know what they have been in years past and we estimate them as best we can for the future. If there should be a drastic increase in the income tax rate so that our absorbed premium is increased, then our dividend is decreased to the policyholder. It is all automatic.

Q. But that is not the question. The question is how does it affect the initial total deposit premium that you require? Does it affect it at all? A. I am sorry, but I do not see how we can answer that any other way.

BY MR. PARKER:

Q. In a sense I may be responsible for suggesting the question to the Commissioner, and perhaps I could clear it up. Let us say that you fix \$1,000 as the initial deposit which a new member is required to make for



a certain policy. In arriving at that \$1,000 you have considered first the nature of the hazard, and there is your experience, and you know of certain taxes, which you take into consideration. You expect that at the end of the year out of that \$1,000 you will be able to return say \$400. Do you follow me so far? A. Yes.

Q. That is, with taxes at a given rate all the way along. Now, suppose my policy expires and I come back to you for a renewal. It is the same hazard, the same man, the same property. But let us imagine that just at that time the authorities have upped the income tax by a very substantial rate. Would you then say, "Mr. Parker, your last deposit was \$1,000, but now we have to make it \$1,100"? A. I see where the difficulty is now, because I was dumb.

Q. Would you fix my deposit at \$1,100 or simply say, "Your deposit will be the same as it was before, on the understanding that instead of getting back \$400 this year you will get back only \$300"? A. That is the way it would work. We were confusing gross deposit and the net premium.

Q. In that case I would suggest to you that perhaps your answer to the question may need some modification, that the amount of the income taxes that may be imposed upon you does not affect the amount of the initial deposit? A. That is correct. It comes out of the deposit eventually.

Q. It does affect the actual cost of the insurance to me? A. It does.

Q. It is passed on to me eventually? A. That is correct.





Q. That imaginary case which we have dealt with is typical, and that is your method of operation? A. Yes.

Q. This Commission is instructed to find out how companies operate. That is your method? A. Yes.

Q. Now, I having become a member, do you keep a separate account for me? Do you keep a separate account for each insured? A. Yes, but the experience of all is grouped, so that the absorbed premium is charged against all the policyholders. I mean, there is not a different absorption on the textile class as against the machine class or some other class.

Q. Let us come back to my question. I am merely asking, in your company is a separate account kept throughout for each insured? If I became a member of your company would I find at your office a ledger account for me, in my name, showing that I became a member on such and such a date, that I paid such and such a deposit on such and such a date? A. Yes, that is correct.

Q. And that is true with regard to every member? A. Yes.

Q. As a loss occurs is the amount that I have to contribute charged up against me? A. Your proportion out of the total.

Q. That would show in my ledger account?

MR. GRAY: Not immediately.

MR. PARKER: Please wait until he has answered.

MR. GRAY: He is misleading you.

MR. PARKER: I do not think he would do that.

MR. GRAY: Not intentionally, but through misunderstanding you.



BY MR. PARKER:

Q. After I have become a member your ledger account would show that you received from me \$1,000? A. Yes.

Q. That would be the first entry? A. Yes.

Q. Say that three weeks later a heavy loss occurs, which the company pays, and I have to contribute my proportion of it, my account would have to bear a proportion of that loss? A. Your account would be charged with your proportion. But that is equally true of everybody else's account.

Q. I realize that. I am only asking about one account as an example.

MR. GRAY: Ask him when the charge is made.

MR. PARKER: I will, if you will give me time. I cannot ask about everything at once.

BY MR. PARKER:

Q. I am merely asking if each loss to which I have to contribute is charged against my original deposit? A. Yes.

Q. Now, as Mr. Gray wants me to ask, when is that charge made? A. At the end of the month we close our books and we add up the losses, the expenses for the month, the income for the month.

Q. That is simple. You need not go any further. Is it done monthly? Are all other charges against that account squared monthly, charges such as taxes and incidental expenses to which I might have to contribute? A. I do not want to mislead you. The absorbed part of the premium that is applicable to all policyholders for the month is determined, and there is a summing up--if you want to see this sheet--



Q. No; just tell me. A. That goes into the account. Perhaps I can explain that further.

BY MR. GRAY:

Q. Will you file the form, please, Mr. Freeman?

MR. PARKER: I wish my friend would not interrupt me just as I am trying to ask a question.

MR. GRAY: I beg your pardon.

BY MR. PARKER:

Q. I am trying to get a visual picture of my account in your ledger. A. Your account and everybody else's account is treated the same way.

Q. Exactly; I assume they would all be treated alike; I never suggested there was any difference. Monthly there is charged against each member's account his proportion of the share of losses for that month? A. Yes.

Q. My next question is simply this: do you monthly charge everything else against each member's account that is properly chargeable by way of expenses or anything else that goes to make up this absorbed premium? A. Yes.

Q. Is that done monthly or is that general expense left till the end of the year? A. It is done monthly, but that is not charged back against the member's individual account each month.

Q. What is charged against my account and everybody else's account monthly? You told me that something was. What is it? A. The proportionate share of the losses and expenses. Then we make a summation of those for the number of months your policy is in force. If your policy is terminated then or is cancelled then the summation of those monthly charges--

Q. I was not asking about any of these things.





I am assuming that I stay a member for a year. Let us think of it in that way. A. You would have against your account, based on our January 1945 computation book sheet, a total of 6.58 per cent of the premium deposit as absorbed.

Q. I am not interested in those details. I am merely asking if you charge against me monthly my share. Do you enter it in there monthly? Am I right on that?

A. Yes, it is entered monthly, but not against the individual accounts.

Q. Whom is the entry against? A. It is carried on the books, that is the charge for the month for all policyholders; it is not charged back to the individual account.

Q. When is it put in the individual's account? A. When his policy terminates.

Q. That is certainly not what I understood you to say a while ago. I thought you said it was charged in each individual account monthly. A. No.

Q. It is not set up in his account, you say, until the expiration of the term? A. When his policy terminates the summation is made.

Q. When is any part of that original deposit picked out and set aside and marked as a reserve? When is the proper entry on the book shown? A. After the policy terminates.

Q. When these adjustments are made, if a member wanted to retire at that time he would be paid his proper share? A. He would be paid the unabsorbed premium deposit.

Q. Suppose I was in there for a year and for some



reason or another I decided I did not like it and wanted to get out at the end of the year. A. To answer that specifically, on the basis of last year's operations, we would have shown over all members' accounts for last year unabsorbed earnings of 93.42 per cent. We returned 92 per cent, so we credited to reserve on all accounts 1.42 per cent.

Q. As to the amount that you have retained, is that really the cost of the insurance on me for a year, or is it something quite different? A. That is the amount you would be billed for, yes.

Q. I would be through then once for all? A. If you got out you would get back 92 per cent.

Q. I want you to tell me whether what I would get back would represent the actual cost of my insurance. A. You would not get back the 1.42 hundredths per cent of the original deposit.

Q. Why do I not get that back, if I am carried at cost? A. That goes into the reserve.

Q. Who gets it? Whose is it? A. The policyholders.

Q. What policyholders? A. Insurance is a continuing business.

Q. What policyholders? Supposing all the policyholders but two get out, and supposing we all left our 1.42 per cent, who would get that? A. This would go to the ultimate policyholders.

Q. If the policyholders got down to two or three, those two or three would get it all? A. The policyholders of the last six years.

Q. If those policyholders for the last six years





got out one by one until the number of policyholders was reduced to one or two or three, those few would finally get all the aggregate of this 1.42 per cent? Is that not correct in theory? A. No.

Q. What is wrong with it? A. In case of liquidation of the company it is to go to the policyholders who have been members during the last six years. That is to prevent what you are talking about happening.

Q. Then anybody who got out prior to the past six years and left his 1.42 per cent in would not get that back? A. If he got out seven years ago he would not get it back.

Q. I am only trying to find out what happens to the amount that is retained when any member retires. The amount that is retained, whether he retires or not, is not just exactly the cost of the insurance? In other words, this company is not doing business at cost? Is that not correct? A. It is correct as far as it goes.

Q. What part have I left out? A. That money stays there, it can only go to the policyholders in the end.

Q. To some policyholders, not to all who contributed it? A. Some policyholders.

Q. That is quite a different thing, I suggest to you.

MR. GRAY: May I help clear that up before you leave it?

MR. PARKER: I would rather you cleared it up after I have finished, if you do not mind.

MR. GRAY: Very well.

At 12.30 p.m. the Commission adjourned, until 2.15 this afternoon.



The Commission resumed at 2.15 p.m.

Examination of Mr. H. T. Freeman continued

BY MR. PARKER:

Q. Before lunch I had asked you some questions about monthly charges to each member. That is, that the summation of those monthly charges during the term of the policy, subtracted from the original deposit, would represent the amount returnable. A. Yes, the available for return, we would call it.

Q. Yes, less  $1\frac{1}{2}$  per cent in each case? A. Yes.

Q. And I had suggested to you that that small percentage represented profits to the company. And perhaps I had omitted to bring out that although the individual member did not get back the  $1\frac{1}{2}$  per cent, or whatever it is, out of the money he put up, yet he got the equivalent out of a similar amount from his predecessor member, from whom it had been deducted. A. Yes, that is true, and it is very important. The man who comes in at the last, as Mr. Parker suggests, and stays only one year--and of course that seldom happens--has the advantage of prior contributions by prior policy holders, which is of much more importance than the little, measly  $1\frac{1}{2}$  per cent that he may leave with the company.

Q. Let us go back to the inception of the company, to the first group from whom the  $1\frac{1}{2}$  per cent was taken; how did they get the equivalent? A. Well, while I have grey hair, I did not live 108 years ago, so that that is, sir, a hypothetical question. I do not know how they did it at that time. I should like at this time, or at some time before the meeting closes, to clear up one other point which you raised, Mr. Parker.



Q. Yes, you may clear up anything you like, where you might have misunderstood my question, or left the wrong impression. Go ahead and clear it up. A. Yes. I refer to this highly theoretical idea of yours, Mr. Parker, where policy holders might drop out, or be forced out, and those tremendous reserves ultimately be found in the hands of two or three policy holders. Of course that is impossible. In the first place, we have annual meetings. We send to every policy holder a very, very complete annual statement. In that way he knows what is going on. We have fifteen directors, and those directors are outstanding business leaders. They, of course, would not for one moment stand for any monkey business of that kind, at all. Then, on top of that, we have protection in the charter which states that in the case of reserves the funds have to go back to the policy holders of the past six years. So that what Mr. Parker has suggested might happen cannot, in actual fact, happen in our case. I hope I have made myself clear.

Q. Yes, I understand. That brings me to another point, and it is this --- A. I beg your pardon, Mr. Parker; are we straight on the question as to that contribution to reserve not being profit -- because it is not profit.

Q. That is the whole question, as to whether it is or whether it is not. A. Well, I would battle that out with you.

Q. I think we understand your contention, Mr. Freeman. We shall come back to that in a moment or two, however, and from a different standpoint. Then, dealing specifically with the company of which you are president, namely the Manufacturer, I understand that company holds





a charter from what state? A. From the state of Rhode Island.

Q. Who are the incorporators? They are certain named persons, are they? A. The original policy holders, they would incorporate.

Q. That is, the company at its inception? A. Yes.

Q. All those named persons, plus all persons who hereafter become insured in this company, shall form the members of the company; and they in turn shall be the body corporate; is that the way it is set up? A. Yes; that is the way it is provided for.

Q. If you wish, you may file a copy of the charter.  
A. Yes, here it is.

BY THE CHAIRMAN:

Q. Are the by-laws also there? A. Yes, they are in there.

Q. In that book? A. Yes, that is a copy of the charter and the by-laws.

Q. So that the members of this company are the policy holders? A. Yes.

BY MR. FARMER:

Q. And when you talk about the annual meeting for the election of directors to transact general business, you are really referring to the annual meeting of policy holders? A. Yes, that is correct.

Q. And, as I said to you, they meet in a dual capacity, first as a meeting of policy holders, and also in the capacity of persons entitled to participate, on certain conditions in the reserves held by the company; do you agree with that? A. They meet primarily as policy holders, and secondarily in the other capacity I have mentioned.



Q. They meet secondarily in the other capacity, is that correct? A. They come up in both capacities.

Q. But in fact, is that not so? A. Yes, I should think so.

Q. You would say that is right? A. Yes.

Q. Then, to go back and to bring up another point parallel with that one: when a man becomes a policy holder, and therefore becomes a member, I think you have told me that there is no formal application? A. That is true.

Q. That would correspond to an application in an ordinary joint stock company; there is no such thing.

BY THE CHAIRMAN:

Q. Most of these policy holders are incorporated bodies, are they not? A. Yes, they are.

BY MR. PARKER:

Q. There is no formal application for insurance, like there would be under the ordinary joint stock company?  
A. No.

Q. But the policy is issued? A. Yes, that is correct.

Q. Have you a specimen form of policy which you could file with us? A. Yes, I have one of the Canadian policies -- or at least Mr. Gray has one, and all those policies contain this clause.

Q. Is this an American or a Canadian policy?  
A. All policies issued by us have that clause.

Q. Before you read it, can you tell me if there is anything in the policy to indicate an obligation on the part of the company that they will account to you and make available to each member its proper share of these reserves? Can you just tell me the number of the paragraph in which that is shown? A. Mr. Gray has





just given me a copy of our form of policy, the Canadian Fire Insurance policy, used in Canada with the exception of the province of Quebec.

Q. Then, this would be the form in use in Ontario?

A. It will be seen that on the third page are extracts of the charter of the company, and also a copy of the by-laws. Then, on the so-called filing back of the policy there is this statement:

"The assured is hereby notified that by virtue of this policy, he is a member of the Manufacturers Mutual Fire Insurance Company and that the annual meetings of said company are holden at its home office on the second Tuesday in January of each year, at three o'clock p.m."

Q. Where do you find that? A. On what we call the filing back of the policy.

Q. Well, after reading this, I find that it is not what I am asking about. What I am asking you is this: is there anything in the policy indicating that the assured is entitled to anything more than to be indemnified against any loss which will be suffered by fire? In addition to that, is there any provision that he will participate in these reserves, on some sort of basis?

A. Well, to answer that, I would have to read over a lot of fine print, because I have not read it for some time.

BY MR. GRAY:

Q. Is it not in the by-laws? A. Yes, it is on the third page of the by-laws.

BY MR. PARKER:

Q. To which one do you wish to call my attention?

A. Section 5 covers it, in the extracts from the by-laws.



Q. That is what I am trying to find; probably No. 4 or No. 5 would cover it. I shall read No. 4. A. I think the two should be read together.

Q. They are as follows:

"4. Each premium deposit for a policy on the mutual plan is to be deemed a deposit made by the insured with the company. The portion of this deposit unabsorbed by the contributions to the company's losses, expenses and reserve, as determined and declared by the board of directors, is to be returned to the insured at the expiration or earlier termination of his policy."

That does not deal with reserves; that excludes reserves, does it not?

MR. GRAY: It mentions reserves.

BY MR. PARKER:

Q. It mentions reserves, where it states: "The portion of this deposit unabsorbed by the contributions to the company's losses, expenses and reserve." You take those three out. Then, paragraph 5 states this:

"Immediately after the first day of each calendar month a computation shall be made for each policy of the mutual plan that expired on said date, for determining what percentage of the premium deposit for the said policy has not been absorbed by its pro rata contributions to losses, expenses and reserve during the life of said policy."

Is there anything in there to show that there is an obligation on the part of the company? A. I think if you will read the rest of the paragraph it will be clear; you should read it all.

Q. Very well; I shall read the rest of it. It states:



"These computations may be by such convenient and practicable approximate methods as in the opinion of the president or directors, having due regard to the reserve, will most accurately and fairly and without purpose of profits to the company...."

A. Please notice that.

Q. Yes, I notice it. It continues -

"....determine for each member all of the premium deposit made by him which has not been absorbed by its pro rata contributions to losses, expenses and reserve.

As the premium deposit is based on the theory of continuous membership, this computation will be sent to members following the expiration date of policies in the form of a statement of the difference between the premium deposit for the new policy and the return of unabsorbed deposit on the old policy.

In case of continued membership, all of that portion of the original premium deposit not thus absorbed shall be returned or credited to the insured, reckoned as a percentage of the premium deposit.

Non-renewal shall be considered as a cancellation and the portion of the premium deposit to be returned to the insured shall be determined under section 6 below."

I suggest to you that there is no obligation in any way to return to the policy holder any portion of the reserve; do you agree with that? A. That is entirely a matter for the directors to decide -- as to what shall be returned.

Q. Yes, I know that; but is there any obligation in





that policy that the policy holder can enforce against the company, in reference to that reserve? Is there any other provision of which you are aware? A. I think that covers it.

Q. All right; I shall read section 6:

"Any policy shall be cancelled at any time upon request of the insured and may be cancelled by any executive officer of the company after due notice as provided in the policy. In all cases of cancellation of policies on the mutual plan that portion of the premium deposit which has not been absorbed by losses and charges for taxes, current expenses and contribution to reserve, and extra charge for short rates as determined from time to time by the directors, shall be returned to the insured reckoned as a percentage of the premium deposit."

Is that what you wish me to read? A. Yes, that all goes together. You had better read the rest of it.

Q. Section 8 is as follows:

"The income received by the company from its investment shall be applied to the payment of expenses of conducting the business, taxes, losses and reserve."

Now, what I wish to bring to your attention is this: let us illustrate with the case of a man who makes a deposit of \$1,000. At the expiration of the first term, you will calculate a number of things. First, your losses are kept separately. You make a distinction between losses and expenses of adjusting losses; or are they put together?

A. That all goes together.

Q. It goes together; in other words, losses and cost of adjustment go together. Then, there are general expenses; is that correct? A. Yes, that is correct.



Q. And those are duly calculated? A. Yes.

Q. And then the reserves are calculated, in the discretion of the directors, as circumstances may require, from time to time. Then, those three are added together and subtracted from the original deposit, and you have the amount returnable. A. You have not mentioned the credit of the income received from investment.

Q. I will come to that. Let us assume, first, that there is no income from investment. What I have said would be correct if there were none. A. Yes, if there were no income.

Q. But in this instance there is a very substantial investment income? A. Yes.

Q. I believe you stated that it was sufficient at the present time approximately to equalize the expense item? A. Yes, that is correct.

Q. And is it the practice that the investment income shall be used for the payment of the expenses? A. That is the practice, yes.

Q. That is, it is not only the practice, but it is carefully provided for. A. Yes, it is carefully provided for in the by-laws.

Q. Therefore, to the extent that expenses are defrayed from investment income, the amount returnable is thus increased? A. That is correct.

Q. Because if that were not so that much more would have to be deducted from the original deposit? A. That is correct.

Q. The result, therefore, is that a part of the cost of this man's insurance is defrayed out of income which is yielded from investments made by the company, and used to defray a portion of the insurance? A. That is





correct.

Q. In other words, he is getting a part of his insurance cost carried out of income from investments?

A. That is correct.

Q. He never actually gets those investments as such, does he? The part that is returned is carefully designated as a returnable portion of his original deposit; is that correct? A. Of course we do not ---

Q. Because the investment income has been used.

A. We do not invest 100 per cent. We keep a certain amount of funds for a working balance.

Q. But my point is that the part he gets back is given to him on the basis that it is part of his original deposit.

A. He gets back the unused portion of his original deposit.

Q. He gets the same amount, but he may get it under two different labels. Supposing he gets back \$400. \$100 of that really represents investment income, and \$300 is returned of his original \$1,000. But where it is paid back to him, it goes back as though it was a part of the original cost, does it not? A. The income received goes back as a credit on the expenses.

Q. Yes; I think we understand each other. Now, you spoke of re-insurance this morning. Did I understand you to say that you only re-insure with each other? A. That is substantially correct, yes.

Q. Is it entirely correct, or is it only substantially correct? A. I would have to say that it is substantially correct, because once in a while we get accommodation requests where someone wants us to help them out.

Q. But you do, to a small extent, re-insure with



others -- other than your group? A. Well, it is so small you could hardly find it.

Q. I am not interested in the size of it; I am interested only in the fact of your doing it in that way.

A. It complicates our books.

Q. But you do, to a very small extent. A. There is a certain amount of accommodation business granted to others. They grant us favours occasionally, and occasionally we grant them favours.

Q. Then, you have spoken of your inspection service. I think you told us that it runs around \$1,000,000 a year.

A. It is around a million and a half, or more than that.

Q. Then, what is this inspection service; is it a separately incorporated body? A. No. We have debated that back and forth for several years. It is a subject which is perpetually under discussion, as to whether we should incorporate our inspection department. When I first came to the field some twenty-five years ago, it was under discussion and it is still being discussed.

Q. And so far you have not become incorporated?

A. No; it is purely voluntary. I should like to explain that further, if I may.

Q. Well, I think we will get along faster if you permit me to do the questioning. You may tell a lot more than is necessary. We are trying to bring out all the facts. I understand that you employed these engineers and inspectors when you wanted them. A. They are permanent employees.

Q. Are they permanent? A. Yes; I think I had better explain that, Mr. Parker.

Q. All right, go ahead. A. Each year the joint affairs committee, to which you refer -- that is, the



company presidents -- adopt a budget which is prepared by our inspection department. It is based upon what they think their expenses will be for the year. The cost of that is pro-rated among the companies on the basis of the amount of insurance in force in each company. Last year we contributed on the basis of \$111 for each \$1,000,000 risk. It was about that figure, I believe. Every company has to contribute on that basis -- on the amount of insurance in force as of December 31. That brings in a sum at the present time of, I believe, \$1,688,000. That money is used by the inspection department, subject to the executive committee of company presidents for payment of inspectors, special engineers, and so on.

Q. What body handles that fund? A. The treasurer of the inspection department.

Q. The treasurer? A. Yes; it is handled by the inspection department. We turn over each month one-twelfth of the annual charge to which we have agreed. That goes to the department, and then the department manager and the treasurer disburse it for salaries, travelling expenses, and all kinds of tests, research, and the like.

Q. Is he the treasurer of one of the constituent companies? A. No, he is the treasurer of the inspection department. He is a properly appointed official, if that is what you are getting at.

Q. No, I did not mean that. I want to know if that is an engineering service of yours, more than of one of your constituent companies? A. It is jointly shared by the eleven companies. My office has a third of the system, and contributes roughly one-third of the expense.

Q. And does that service, or its employees, do work





on inspection for anybody else but your companies?

A. No.

Q. They are full time? A. Well, maybe once a year, if somebody wants an expert, we may permit one of our men to pick up an extra hundred dollars; but that is very rare.

Q. That would be simply a bonus for the man, personally; it would not go to the coffers of the company?

A. No.

Q. It would just be a present for him. A. It happens only once or twice a year, perhaps. We do happen to have a special man on explosions, or something like that, who might be used by somebody else. And in those circumstances we might arrange to have him so used.

Q. One question which bothers us is that of the legal status of your company, as distinct from the shareholders. Have you ever studied that matter seriously, to see whether the incorporated company is distinguishable from the individual members of the company, in so far as taxation matters are concerned? A. I pleaded guilty this morning to not being a lawyer, and I shall have to continue that plea. That, I suggest, is a legal question which counsel should look into.

Q. I have had many discussions in the past two years with people of your standing, who claim they are not lawyers, but who have at the same time discussed this matter a great deal. A. Well, I think it is getting out of my field.

Q. You do not feel that it is in your field.

A. It is a legal question, and I should like to have counsel answer it.

THE CHAIRMAN: Mr. Gray has answered it in his brief.



BY MR. PARKER:

Q. I wonder if that is Mr. Gray's personal view, or is it the considered view of this company. A. We do not let our counsel run us; it is the view of the president.

Q. It is your personal view? A. Yes.

THE CHAIRMAN: Legalistic was the term used, I believe.

BY MR. PARKER:

Q. You do not feel like discussing it any further?

A. You would get a full answer from Mr. Gray.

Q. Well, I am not so sure about that. A. He speaks your language; I do not. Mr. Gray has been associated with us for many years.

Q. Do you know what an underwriting profit is? What would that be, as applied to your company? A. I do not claim we have any.

Q. Do you know what it is? A. I have seen the computation made.

Q. If you will not talk to me in my language, you can talk to me in yours. I have heard of the expression "underwriting profit". Have you heard that expression? A. Yes.

Q. What does it mean, with respect to the Manufacturers Mutual Fire Insurance Company? A. It is not in the factory mutual method of doing business at all.

Q. I am not quite sure I understood you. I asked what underwriting profit was, and I think you undertook to tell me that it is not something --- A. I would have to have a copy of the blank and refresh my memory.

Q. Then, you cannot tell me what an underwriting profit is, from your standpoint? It may be quite different in a joint stock company from what it is in





your company. . A. It is the difference between loss and expense. It is the unearned premium left over after paying losses and expenses and contribution to reserve and credit of the income from investment. That is roughly it.

Q. It is the difference between premium and what else? A. It is what you have left over after you get through paying losses and expenses.

Q. Left over out of what? A. Out of your original.

Q. Your original premium? A. Yes.

Q. As you understand underwriting profit it is the difference between the amount of the premium paid on the one hand --I am not speaking of depositors, but I am talking of the premium paid--less losses and cost; is that not what you understand by underwriting profit?

A. Yes; but I must say that the system is very different when applied to our system.

Q. I think I understand that by premium you do not mean the amount of deposit made in your company; that is not what you mean by premium. A. No.

Q. What portion of the deposit is the premium?

A. It is the net premium retained after you have made your return to the policy holders. And that net premium represents your cost.

Q. In your system of doing business is there such a thing, at all, as a premium paid by the insured? Does the insured pay a premium? A. After his policy has terminated, the net premium that is left -- that is his premium. It is taken out of the original deposit. It is not a premium until the computation has been completed and the transaction has been completed.

Q. It ripens into a premium. A. Part of the



original deposit eventually does.

Q. So that there is an amount which subsequently becomes a premium, in the same sense a premium is used in the ordinary joint stock company. A. Yes, it subsequently becomes a net premium.

Q. And that net premium is exactly equal to the losses and expenses? A. And the contribution to reserve.

Q. Contribution to reserve. A. Yes.

Q. That is, the premium in the mutual company. A. Yes, that is the net premium.

Q. Therefore I suggest to you that on the basis of your own definition those reserves represent underwriting profits. A. No, they do not; I cannot agree with you on that.

Q. You do not agree with me? A. No.

Q. All right. You appreciate that portion of the briefs in which it is stated that the Superintendent of Insurance has misapplied or misunderstood these figures filed by your company, in setting up his report. You agree with those criticisms, do you? A. Yes; I think that is true of not only your Dominion Superintendent, but in respect of all blanks; because they are prepared primarily for the use of capital stock companies, and not for the use of companies operating on the premium deposit plan?

Q. Do you make a similar return to anyone in the United States for American business? A. A similar statement is prepared. We never have objected to it, particularly, because it does not do us any harm. It sets up large reserves; so what?

Q. At page ten of the first brief, we find this:



"A fact which must be kept clearly in mind at all times is that the original deposit, which is purposely large in the case of the Factory Mutual Companies, is a deposit and not a premium in the usual sense of the word."

What is meant by the expression "not a premium in the usual sense of the word." It is a premium in what unusual sense of the word; or is it a premium at all?

A. It is a deposit out of which the final net premium is taken.

Q. You attended before the Congressional Committee in 1942 in connection with this matter? A. Yes.

Q. And, following that, certain recommendations found their way into the legislative program of that country, in the following year? A. With respect to the taxation of mutual companies, yes. For thirty-two years, that is from 1910 to 1942, Congress has struggled with this problem. Finally, as a war measure, knowing that the government needed money, we agreed to that method of taxation, although it is working out in such a way that we are now paying more than was contemplated, and more than our competitors are paying, on a comparable basis. But as a war measure we are willing to make our contribution in that fashion.

BY MR. ARNASON:

Q. Was that tax levied because Congress believed that you, as a mutual company, had a profit, or was it levied because of the need for revenue? A. We never admitted that we had a profit. I proposed that method of taxation, because we wanted to make a contribution to the war effort, and that was one way in which we could do it. We have protested, and for years have objected to the attempt by





Congress to tax us on profits, where there were no profits. But when they adopted this system of taxation, it was on an optional basis. I wish I had a copy of the law to show you. We have two options, one of which is roughly 40 per cent of our investment income which applies, in our case, from 1 per cent of the premium, interest, income, and certain other items, and deductions. Some mutual companies are paying under one option, and others are paying under the other. Under the law you have to pay whichever gives the greatest tax. We have to pay under the 40 per cent of investment income regulation, and we are so paying. But we have in mind, when the war is over, and the need for income decreases, that we are going to ask for relief.

BY MR. PARKER:

Q. As a result of that legislation, mutual companies such as yours, were taxed, were they not? A. Yes, they were.

Q. And they were taxed on this basis, were they not, that certain items were deducted as operating expenses from your gross income; is that not correct? A. Yes, that is correct. I have a copy of it right here -- the annual income tax form.

Q. Certain deductions were allowed from your gross income, and then the companies were allowed exemption of the remaining portion of the income, up to what percentage? Was it \$50,000? A. I do not remember the figure, whether it was \$50,000 or \$75,000.

Q. I think it was \$50,000 in one class, and \$75,000 in the other class. A. I think it was \$75,000.

Q. But the excess of that was held to be taxable by American authority, and on that excess you have been



paying since then income tax to the United States.

A. Yes. My company paid \$146,000 for 1943.

Q. Your company did? A. Yes.

Q. And what applied to your company would, in varying amounts, apply to all mutual companies? Your company was not singled out, was it? A. No.

Q. Is the amount of money on which you are paying income tax in the United States in respect of your American business? I would suppose that that is the way it is worked out. Or do you take in your entire business in arriving at that? A. I think it takes in the entire business. But I think we get credit for what we pay in Canada. I should like to check that, to make sure.

MR. GRAY: But there is none in Canada.

BY MR. PARKER:

Q. You get a credit if, as and when you pay?

A. I am very sure we are allowed to deduct any taxes we pay to the Dominion Government, as money deductions. I was trying to find the item, but I am afraid I cannot find it just now.

Q. What I am interested in is this, in respect of the business carried on by this company in the United States, that after a thorough examination the United States Congress enacted a law which taxes the Factory Mutuals as having income, and gave them certain deductions or certain exemptions; then on the balance they levied a tax to be paid. A. There is no denying that; that is correct. We volunteered it, as a matter of fact.

Q. I do not care whether you volunteered it or not.

A. I wish to make it clear. We do not pay it as a tax on taxable income.

Q. Does not the United States law say that you shall





pay it, whether you wish to or not? Is it not a tax law?

A. Yes, it is a tax law, certainly. But I do not say it is a tax on profits. In fact, it is not a tax on profits.

BY THE CHAIRMAN:

Q. Is it a tax such as the Special War Revenue Act in this country? That is not an income tax, is it?

A. I have wondered sometimes whether the government have not accepted that in lieu of income tax, in view of the fact that we pay a bigger tax, proportionately, than do the stock companies.

BY MR. PARKER:

Q. Is the fund on which it is paid in the United States any different from the same fund which you hold in Canada? Do they not arise in the same way? A. If you mean is it a tax with respect to our investment income I would have to answer yes. That is the basis of the tax.

MR. GRAY: There is always the alternative, whether you pay it on the income or on the premium, depending on which is the larger. It is gross income, not net income.

BY MR. PARKER:

Q. But does not the whole thing pre-suppose that you have an income? Quite apart from what the practice is, is it not written right into the by-laws of your company, in your charter, in a great many ways, dealing with the income of the company? You have income; there is no question about that. A. There is no question about it; we have income.

Q. If you have income, on what basis have you taxable income? A. Because income tax is a tax on profit; and that is a very different thing from a tax on income.

Q. Perhaps, but if you have a net income you are



getting pretty close to a profit, are you not?

A. You are getting into the legalistic field again, which is over my head.

Q. It seems to me that I get into that field every time I get too near the tax.

BY THE CHAIRMAN:

Q. Mr. Freeman, you do not get credit for the income tax paid in Canada, when you pay income tax in this country -- that is, when you make your payment to the American tax gatherer, do you? A. I think there is credit for that tax in our form.

Q. Do you get a credit for the special war revenue tax paid in Canada? A. Yes.

MR. GRAY: I think Mr. Freeman is right when he says that there is credit given for taxes paid in Canada, on the ground that that is, in the case of the Factory Mutuals, a tax on investment income, and therefore relevant.

THE CHAIRMAN: Well, is it on investment income?

MR. GRAY: It has been represented to the United States authorities, and accepted by them, that the tax Factory Mutuals pay in Canada under the Special War Revenue Act includes a tax on investment income, and I am informed there is a credit allowed in the computation of the United States tax for the whole or part of the tax paid by Factory Mutuals under the Special War Revenue Act. This return, if examined, will show that. And I think my learned friend Mr. Parker may well want to have this filed, because it is an actual computation of tax actually paid.

MR. PARKER: You may file it.

MR. GRAY: And will you permit me to add one other



item of information which I gather from this form. The tax, as Mr. Freeman has said, is on two alternative forms, and they pay that which is larger. In the one case the computation is on the basis of investment income, after the allowance of properly computed investment expenses by way of deduction. The alternative tax, as I understand it, is a tax on gross income, with certain deductions allowed such as interest, investment expenses, taxes, real estate expenses, depreciation and other capital losses -- but no deduction for losses or expenses. Therefore it is not a net income tax. Is that correct?

THE WITNESS: Yes, I think that is correct.

MR. GRAY: So that the important thing for Mr. Parker to note is ---

MR. PARKER: Let us not enter into a lengthy argument at this time, when I am examining the witness.

MR. GRAY: The important thing to note is that this is a gross income tax, and not a net income tax.

MR. PARKER: I shall read from another brief which I have before me, from the American Mutual, which states:

"The Revenue Act of 1942 placed section 207 in the Internal Revenue Code in its present form. It has not been substantially amended since 1942. This section provides for the taxation of mutual insurance companies, other than life, marine or fire companies issuing perpetual policies exclusively. Mutual fire and casualty companies in which gross annual income from premiums, assessments, interest, dividends and rents is in excess of \$75,000 are taxed on whichever of two bases produce the higher tax.

1. Investment Income Tax. Net investment income is taxed at regular corporation income tax





rates.

2. One per cent gross income tax. Net premiums plus gross investment income, less tax free interest, are taxed at one per cent. Net premiums are: gross premiums less return premium, premiums paid for re-insurance and amounts returned to policy holders on the basis of experience, i.e., dividends to policy holders."

Is that a correct summation of the thing as you understand it? A. Knowing the man who wrote that, and knowing that he is always accurate, I shall say that that is a complete story. It is accurate.

Q. Knowing whom? A. Knowing Mr. Gruhn.

Q. How do you know he wrote it? A. You told me it was from the American Mutual Alliance.

Q. Did he write that? A. I think he did; he had a lot to do with it, I think. He is sitting over there in the corner. You might ask him.

Q. I see his name on it. A. We meet on such occasions as this.

Q. Does it not all add up to this, that from the company's by-laws and from the statute under which it is incorporated, and from practice, everybody seems to agree that this company of yours has income, and that in the United States you are paying income tax. A. we have investment income, sure. I wish to make it clear that we are not opposing a tax. Mr. Gray said that in his opening argument. But what we are saying is that we ought to pay a tax on some fair and equitable basis.

Q. I understand. I am sure everyone agrees that it ought to be fair and equitable. But what I am interested in finding out is whether there is income, so that I can



decide what is fair and equitable as a tax.

BY THE CHAIRMAN:

Q. In respect of the tax you pay in the United States, is your American and Canadian business segregated?

A. No, I would not think so.

Q. So that it is possible that you are paying income tax, or otherwise, in the United States on Canadian business? A. Yes.

MR. GRAY: That is correct.

THE CHAIRMAN: Where you do not pay it here.

MR. GRAY: That is correct; but it is gross income.

THE CHAIRMAN: Yes; well then, is the Superintendent of Insurance so wrong when he wants to segregate the two?

MR. GRAY: There would be no objection from the Factory Mutuals to segregating the two on a proportionate basis.

THE CHAIRMAN: You can see that that is hardly a fair situation, is it? If the Canadian business of this company is paying a tax in the United States, would it not be advisable to segregate the two so that Canada could take its share and the United States take its share?

MR. GRAY: Yes, decidedly; I think the Factory Mutuals would not disagree with that at any time. But actually what is happening is this: this is a gross income tax, including Canadian income and United States income. It results in the computation of a certain amount of liability for taxes, from which credit is given for the tax now paid in Canada.

THE CHAIRMAN: But that is different.

MR. GRAY: I am not able to tell this Commission whether the deduction allowed in respect of the Canadian tax equals, exceeds or is less than the proportionate amount which would be assessable in the United States on





the Canadian income. We could include them, and let the Commission know.

THE CHAIRMAN: It requires clarification.

MR. GRAY: And I would be glad to confer with Mr. Glassco, if you wish, to try to find the right answer to that inquiry.

THE CHAIRMAN: I would like to have it.

MR. VAUGHAN: Does it also mean that the Canadian policy holders are paying a portion of the \$143,000?

MR. GRAY: Yes, the proportionate part.

MR. VAUGHAN: It does not seem fair, does it, that the Canadian policy holders are bearing a part of the tax paid in the United States.

MR. GRAY: Except in mutuality one cannot divide the expenses without getting into all sorts of difficulties with regard to those expenditures. For instance, one has to consider how much is spent in Canada for inspection service, and how much of the general manager's salary should be charged to the Canadian policy holder. You get into all those difficulties. So that the mutual system seeks a practical answer by saying that all their expenses are in common, and all their income is in common, and they share equally in both.

THE CHAIRMAN: Could you criticize the Superintendent of Insurance for endeavouring to segregate these two?

MR. GRAY: His basis, we say, is quite unrealistic.

THE CHAIRMAN: You do it only for the purpose of saying that he is misleading the public as to the situation of the mutuals.

MR. GRAY: That is correct; and from his publications very unfortunate conclusions have been drawn by many



people throughout the country.

MR. PARKER: That cannot affect the taxability of the company.

MR. GRAY: No, not at all; of course not.

BY MR. ELLIOTT:

Q. The American policy holders presumably also bear their proportion of the 4 per cent Canadian tax.

A. That is true; it works both ways. Over the years the Canadian policy holder has benefited to a great extent by having his interests pooled with those of people south of the border. There is a greater proportion of business over which to spread losses, and therefore costs have been reduced.

Q. So that the Canadian policy holder bears his share of the American tax and the American policy holder bears his proportionate share of the Canadian tax. A. That is true.

BY MR. PARKER:

Q. We have talked a lot about this company's investments. Were those investments carried from head office in the United States or from the Canadian office, or were they kept separate? Can you distinguish? A. With the exception of special deposits, where we have a certain fund on deposit with the National Trust Company, all of our investments are carried at the home office, in the vaults of our local banks. There would be a few scattered non-union companies in control of state insurance departments; but other than those, they are all at the home office.

Q. Is there any way to segregate what you might call investment income earned in Canada, which would properly be called Canadian income, from American income? Perhaps



my question does not make sense. A. Yes, - but you would spoil the setup. You may say that 8 per cent of our business is of Canadian origin, meaning 8 per cent of Canadian income. But that is not the way it works out.

Q. It would be more or less arbitrary? A. Yes.

Q. I am more interested in the type of investment. Are they government bonds, mostly, or do you own common shares of some other companies? A. If you do not mind taking the time, I would have no objection to showing you our investments.

Q. I do not wish to take the time to do that; just answer the question. A. I can answer it in this way, that my own company, the Manufacturers Mutual Fire Insurance Company, have roughly 50 per cent of its investments in Canadian or United States government bonds. The balance to the extent of about 35 per cent, I think it is, is in common stock, and then there is a percentage of cash, and premiums in course of collection, and so on.

Q. Have you any investments in any company stock, or the stock of any company of which you have control -- or which you control outright? A. We do not control any company through stock ownership.

Q. None at all? A. No.

Q. Neither in the United States nor in Canada.

A. No. I suppose you might say we control our office building. We have stockholders in our own office building. It is owned by the factory mutual companies in Providence, and there are a great many stockholders.

Q. If a situation existed whereby the money which you invest out of your reserve is invested in a company which you control, and which in turn is making money -- you say that does not exist? A. We have no controlled





company, other than the building company. And my company's share of that is only about 40 per cent.

BY MR. MAIN:

Q. I have one or two short questions to ask. I observe in section 7, at page 7 of your charter, these words, "in addition to any re-insurance for other reserves." You will observe those words; what do you mean by re-insurance reserves? A. That is the re-insurance reserve required by law. It is set up in the annual statement blank. It is on a basis that has stock insurance companies in mind, and not companies such as ours in mind. That is very well illustrated by the chart which appears at the back of the brief.

Q. Have you never set up a re-insurance reserve? A. It appears every year, as in the case of all companies, stock or mutual. They make a computation.

Q. You do; that is for re-insurance which you may have accepted? A. It is a statutory reserve, yes.

Q. And that reserve is for the purpose of meeting any re-insurance which you may have accepted? A. No; you are confusing two things.

Q. Give me the two different types of reserve or re-insurance. A. In the case of a company which gets into financial difficulties, for instance, probably the insurance department may require that the company re-insure its outstanding liability.

Q. That is the unearned premium reserve? A. Yes, unearned premium reserve.

Q. But is there any other meaning for re-insurance reserve in your charter; is there a meaning other than unearned premium reserve? A. I think in all of our funds over and above our unearned premiums we always



refer to them as conflagration reserve.

Q. But this is in addition to the insurance reserve which may be required by law. The paragraph continues in this way:

"It shall be lawful for said corporation to establish and maintain a reserve against extraordinary losses, by appropriating from time to time, from the net income of the corporation, such sums as the directors may determine; provided, that the sums so appropriated in any year shall not exceed one-half of the premium deposits received during that year."

A. That is correct.

Q. That is the catastrophic reserve which you mention? A. Yes. That is the difference between our actual earnings, 93.42 per cent and 92 per cent we paid. That is the difference of 1.42 per cent which goes into the conflagration reserve.

Q. And the reserve I first mentioned, the re-insurance or other reserve, is the ordinary unearned premium reserve which you are required by law to maintain; that is what you mean by those words, is it? A. There is the re-insurance reserve, which is statutory, and then beyond that are these contributions determined by the directors, which go to the conflagration reserve.

Q. But you say there are three mentioned in section 7, that three reserves are mentioned. First of all there is re-insurance; that is the first adjective. Secondly, there is the other reserve; and, thirdly, there is what is called the conflagration or catastrophic reserve. A. It all goes into the "other" reserve. It is just one other fund there.

Q. There is no other special reserve, then, than



premium reserve and catastrophic or conflagration reserve.

A. That is all.

Q. Then, at page twenty-one of the by-laws, in the second paragraph of section 2, you will observe that the policy may be continued in force by the attachment of a rider? A. That is correct.

Q. By what method or procedure is that continued in force? Is it at the request of the assured? A. Yes.

Q. So that the policy does not become cancelled; it merely automatically continues. A. You extend it, as all insurance companies do.

Q. The policy continues in force if a rider is attached? A. Yes.

Q. And no matter whether it is one or two or three years, so long as a rider is asked for, it continues in force. A. Subject to certain regulations of the Insurance Department which say that you cannot extend over a certain period of time; that varies in different states.

Q. You say five years. A. Yes.

Q. So I take it that at the end of five years, if you continued a one-year policy for that length of time, there would be a cancellation? A. A cancellation or termination.

Q. In the meantime the deposit would do duty for premiums, as deducted. A. Yes, in the meantime absorptions go out.

Q. You are familiar with the War Damage Act of 1939 or 1940? A. The Canadian War Damage Act?

Q. Yes. A. More or less.

Q. Have your companies undertaken the service of any policies on behalf of the government? A. We





have written a very large sum, yes, on behalf of the government.

Q. And for that service you got  $2\frac{1}{2}$  per cent, I take it, not exceeding \$250 on a policy. A. I think there is a limit on it. I do not think we actually get  $2\frac{1}{2}$  per cent.

Q. You get your expenses up to  $2\frac{1}{2}$  per cent.

A. Yes.

Q. And if your expenses work up to  $2\frac{1}{2}$  per cent you are entitled to get that? A. Yes, but I do not think it comes anywhere near that.

Q. Perhaps not; but as a matter of fact you are entitled, are you not, to 5 per cent of the premium commission? A. That is the so-called producer's fee.

Q. And you do get that? A. Yes, that is correct.

Q. And it is limited to \$500 a policy; you do get that, and you have written a very substantial amount of it? A. Yes.

Q. At page fourteen of your grey covered brief I find this:

"It will be noted that the words 'underwriting gain' and 'underwriting loss' as printed in the exhibits have been struck out by the company when filling in the return, and this is the uniform practice of the factory mutual companies when completing this return."

That is the return referred to as Exhibit No. 1, is it not? A. Yes.

Q. I notice in the exhibit that the words "underwriting" appear to be inked out. Is that the uniform practice throughout the United States, or do you refer only to Canada there? A. No, I think it is uniform



practice everywhere.

Q. You think so; but is it? A. I would have to check that.

Q. Well, you would say at least that it is uniform practice in Canada that that is crossed out? A. And I think it is true in the United States, also.

Q. You think; it is. A. I have not a blank here, but I think it is.

Q. Would you look into that and tell us some time.  
A. Yes, I will.

MR. PARKER: At page one of the yellow brief, and at the top of page two, there are references to marine insurance figures. I understand a gentleman is present representing some marine insurance interests, and he feels that his clients' names, having been brought into the picture to some extent, he would like to say a few words.

THE CHAIRMAN: Have we finished with Mr. Freeman.

MR. PARKER: With the exception of Mr. Gray's examination.

BY MR. GRAY:

Q. I wish to ask only one or two questions with regard to Mr. Mann's inquiries respecting war damage insurance. Is it correct to say that the 5 per cent acquisition or management allowance -- is that what you call it? A. Producer's fee.

Q. Is it correct to say that that fee is limited to a maximum of \$500 in respect of any single policy or risk. A. I think that is the law in Canada, yes.

MR. MANN: I said that.

BY MR. GRAY:

Q. Are you able to say what proportion of your



business was subject to that limit? A. I cannot answer that offhand.

Q. Now, so far as the  $2\frac{1}{2}$  per cent is concerned, I think it has already been made clear that you do not receive  $2\frac{1}{2}$  per cent, but only reimbursements and actual expenses; is that correct? A. Hardly that. I do not think we actually get all our expenses.

Q. The question I wish to ask is this: can you say whether the company derived any profits from the operation of the Canadian War Damage scheme? -- and by profits I mean excess of receipts over disbursement by the company. A. Not from the fiduciary fee. As to the producer's fee -- well, I never made a calculation to know whether that would reimburse us for the time of our men in Canada. I should be inclined to doubt it.

Q. At any rate, may I put it this way, that although you cannot state definitely, or cannot give a definite answer to the question, it is not to be assumed, without further inquiry, that you made any profits out of the Canadian War Damage government scheme? A. That is correct.

MR. PARKER: And it would be just as proper to assume the opposite, I should think.

BY THE CHAIRMAN:

Q. Is the \$500 not to be assumed as income? Unless the contrary is shown, it would be assumed to be income?

MR. GRAY: We had better have some further inquiries made, because the \$500 maximum applies to risks that run sometimes to many millions of dollars.

MR. PARKER: It would take only five minutes to write a policy.

THE CHAIRMAN: These things will be reflected in the





statement which will be submitted, I should think.

MR. GRAY: I think you will find material in that which has been filed to answer the question. There may have been an inference from Mr. Mann's questions that this company, or any other factory mutual company, had been making profits or gain out of its functions in connection with the Canadian government war damage scheme. As I say, the witness is not prepared to give the Commission a definite answer on the point, and I should like to have the privilege of submitting an answer when he has had time to make inquiries.

THE CHAIRMAN: Very well.

BY MR. MACKENZIE:

Q. My questions will be brief. I take it that there is no one of your companies that has any association with or connection with the marine business. A. No, we write no marine insurance.

Q. None whatsoever? A. No.

Q. And consequently, I take it, there is no competitive feature between your various companies and the marine underwriters. A. It might work the other way. The marine companies might write fire business, and in that way compete with us.

Q. But as marine policies. A. We do not compete with them in the marine field because we do not write marine insurance.

Q. And none of your companies has any experience in marine insurance business? A. No.

Q. I notice at page four of your main submission the words:

"The factory mutuals are not concerned whether stock companies pay or do not pay income and



profit taxes."

That is in the third paragraph. A. Yes.

Q. I take it you subscribe to that statement; it is your statement?

THE CHAIRMAN: He said it a minute ago.

BY MR. MACKENZIE:

Q. Then, I should like to ask this question: would you be prepared to use the same language with respect to the payment of marine taxes, the tax on marine premiums by marine underwriters? It would not concern you, would it, or any of your companies? A. Only in this way, that my feeling is that the Canadian government needs money, and if they are going to raise it from the insurance industry they ought to raise it from everybody, and not restrict it to the mutual fire companies or stock fire companies. It is a job we should all shoulder.

Q. Your suggestion is that there may be some sort of taxation that they have not yet tapped. A. That might be possible. I know very little about marine insurance. Maybe you have an argument, but I do not see it.

Q. Perhaps that is one reason why you are before this board. All right.

MR. GRAY: I said in the beginning that after the Commission had heard the testimony of Mr. Freeman I wished to refer to the supplementary brief of the factory mutual companies. Is this the time for me to do so?

THE CHAIRMAN: You do not propose reading it, do you?

MR. GRAY: No; I wish to read only a few selected excerpts from it.

THE CHAIRMAN: Very well, proceed.

MR. GRAY: However, I should like to meet the wishes



of the Commission as to whether I read any of it or not, because I feel we have already been well and fully heard. Perhaps it would be imposing upon your patience.

THE CHAIRMAN: I can assure you that every member of the Commission has read this supplementary brief perhaps more than once.

MR. GRAY: Then, I think I might very well abandon my original intention.

THE CHAIRMAN: There will be no difficulty on that score. I believe we have all the necessary material there.

MR. GRAY: I shall leave it with the Commission as it is, then. But in closing the submission for the factory mutual companies may I file some documents and material I think might be of help to you.

THE CHAIRMAN: I understand you are getting in touch with Mr. Glassco in regard to the complementary material which may be desired.

MR. GRAY: Yes. It may be useful for the Commission to have a copy of the report of the Ontario Superintendent of Insurance, for the year 1942 -- although similar information for any other year would be suitable. I believe that in this will be found the names of all the registered and licensed insurance companies, according to the character of their company organization. Joint stock companies are listed, as are mutual insurance companies. The registrar may find this useful.

Then, I should like to leave with the registrar the Privy Council case in 1931 which had to do with the status of the factory mutual insurance companies under the Special War Revenue Act, and the factum in the Supreme Court of Canada of the Mutual Boiler Insurance





Company of Boston, in which the final determination of the legal status under the dominion law has been set out.

I believe I have completed what I have to say, and I thank you for the hearing you have given us.



MR. PARKER: Mr. Chairman, I think I should mention at this stage that the next brief which it is proposed to take up is that of the American Mutual Alliance; and the one following that will be the mutuals from Quebec. The situation is that the Quebec brief is prepared and will be presented in the French language, and of necessity we must have a French reporter. It is only possible to have him to-morrow, so I should like to have the wholehearted approval of my learned friend Mr. Hayden to begin his case now; let us proceed as far as we can, on the understanding that he might be good enough to let us break in to-morrow to take up the other one.

THE CHAIRMAN: I am afraid we are bound to do that. We can only get the French reporter here to-morrow morning, I believe; and that has been more or less set down.

MR. HAYDEN: There is no necessity for any explanation. I can see that it is necessary, and that is all there is to it.

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AMERICAN MUTUAL ALLIANCE

MR. HAYDEN: Mr. Commissioners, I am appearing here on behalf of a group of American mutual companies, some thirteen in number, who carry on some of their business operations in Canada; and the representations are being submitted through the American Mutual Alliance which is, I suppose you would call it, a business association in which those thirteen companies are members, as well as a very substantial additional number of mutual companies that operate only in the United States.

THE CHAIRMAN: Is the Alliance incorporated?

MR. HAYDEN: No, it is not. It is just an association which has as its purposes and objects just the sort of thing that makes us come here to-day; that is, public relations,



tax inquiries, anything governmental-wise, that might affect the operation of these companies in Canada or the United States.

The brief prepared for presentation to this Commission is as follows:

Introduction

"1. This brief is filed on behalf of the American Mutual Alliance, which is an organization of United States mutual fire and casualty insurance companies, with head offices at 919 North Michigan Avenue, Chicago, Illinois, on behalf of its member companies which operate in Canada under Dominion registry. Appendix I (post) contains a list of these companies and shows the addresses of their head offices and the respective years of incorporation and of commencement of business in Canada."

Before I proceed further may I refer you to the first appendix to the brief, to indicate the mutual companies who are carrying on this mutual insurance in Canada, and whom I represent here. They are thirteen in number. The address of the head office is given in each case, also the year of incorporation and the year in which each of these companies commenced business in Canada.

"2. The net premiums written by these companies in Canada in 1943 (the latest year for which complete government figures are available) totalled \$3,027,302.62, which was 3.04% of the total net premiums written in Canada by fire and casualty insurance companies under Dominion registry in that year. The fifteen-year average (1929-1943) was 3.06%. See Appendix II (post)."

There is an appendix, Appendix II, which contains a statement from 1929 down to 1943 showing in the first column the total premiums received by all the companies in Canada during those various years; then the total





premiums received by the Alliance group which I represent here, then the ratio is worked in each of those years. So you will see that the ratio in 1929 was 2.541 per cent and in 1945 it was 3.043 per cent.

"3. The Canadian business of these United States companies illustrates the international character of the insurance business on this continent. Canadian companies have always been welcomed in the United States as the member companies of the Alliance have been welcomed in Canada. Canadian companies do a large and increasing insurance business in the United States.

"4. At the outset of our brief we wish to point out that mutual companies such as the Alliance member companies pay a 50 per cent higher rate of premium tax, i.e., 3 per cent instead of 2 per cent, under the Special War Revenue Act than do joint stock companies, and that joint stock companies are permitted to deduct the amount of premium taxes paid by them as an expense in calculating their income and excess profits taxes."--

Until 1942, I think it was, they were permitted under our Income War Tax Act to deduct the amount of the premium tax from their income tax. Then, by the amendments which were made to the statute in that year, it is now deductible as an item of expense before arriving at their taxable income.

"--While these taxes are not imposed under the Income War Tax Act or the Excess profits Tax Act, 1940, they are 'matters relevant to the question of the application of income and profits tax measures' to 'organizations organized ... on a ... mutual basis' in the fire and casualty insurance field and as such are within the scope of the inquiry."

"5. The mutual insurance companies which are members



of the Alliance have felt for some years that Canadian tax laws discriminated unfairly against them. With the appointment of your Commission the Alliance welcomes the opportunity of making this submission to the Commission.

"6. In this brief the Alliance will respectfully urge-

"(1) that the rate of tax imposed upon companies transacting mutual insurance exclusively under the Special War Revenue Act should not exceed the rate imposed upon joint stock companies;

"(2) that companies transacting mutual insurance exclusively should continue to be exempt from taxation under the Income War Tax and Excess Profits Tax Acts;

"(3) that the administration of a tax on insurance premiums is simple and effective and can be made equitable; and that the basic tax on all insurance companies should always be a premium tax based on the 'net' premiums, i.e., upon the actual cost of the insurance protection to the policyholder.'

#### General

#### "Insurance and Other Business

"7. Insurance is different from every other form of business activity. The difference is fundamental. All insurance is essentially mutual; most manufacturing and trading, on the other hand, is essentially proprietary.

"8. All insurance organizations of whatever kind gather the contributions or premiums of a large group of individuals into a fund or pool out of which the losses sustained by members of the group are paid. Over a substantial period of time all losses and expenses of a continuing insurance organization must be paid out of the contributions of insured persons. All insurance is protection against loss from possible future occurrences whether or not the organization



has a share capital. Some insurances cover the risk of losses which will never occur to most individuals, e.g., destruction of property by fire. On the other hand, some insurances cover the risk of losses which will inevitably occur although the time of the event is unpredictable, e.g., death.

"9. All insurance is prospective. Money is paid into a fund or pool to give protection for a stipulated period in the future. Only at the expiration of the period can the insurance organization know for certain whether the funds collected for such protection were actually sufficient to meet the obligations assumed. The business of the manufacturer or the merchant presents an altogether different picture.

"10. Whether an insurance business is carried on by a mutual company or a joint stock company or any other type of organization permitted to write insurance, the business itself is essentially different from most other forms of business activity. It makes no difference whether, for example, merchandising is carried on by a commodity cooperative, a joint stock company, a partnership or an individual; the fundamental relationships are essentially different from those which obtain in an insurance organization."

I think the Commission has heard some discussion as to the difference between the insurance business and what we know as commodity cooperatives; I think the essence of it is stated in paragraph 7. That is, merchandising businesses are proprietary in their nature. First of all I should say there is a difference between mutual insurance and any type of ordinary manufacturing or trading operation. Secondly, there is a difference between mutual insurance operation and what I call the commodity cooperatives. I think, for instance, as between the mutual insurance and merchandising





generally there is a vast difference, because mutuality is the essence of mutual insurance. Whoever carries it on, it is mutual in its very essence, whether it is carried on by policy holders or whether you append shareholders to the operations of the policyholders. It is still a mutual operation; that is, a pooling of certain resources of the policyholders, to the end that they mutually protect themselves and provide indemnity against loss.

Then briefly, with respect to the difference between a mutual insurance company and a commodity cooperative, in the first place Mr. Gruhn can bear me out later when I say that mutual insurance companies certainly antedate commodity cooperatives. That may be a surprising statement to the commissioners, but I think I can establish it in evidence; that mutual insurance is older than commodity cooperatives in any organized way.

Then in dealing with mutual insurance you have this feature, that through the mutual operation you have only the policy holders who are the members, who conduct the operation and who are entitled to whatever may be the sum total in the pool of the resources of those policy holders, which they have paid in the way of premium for certain indemnity protection. But then again, when you deal with commodity cooperatives, once you step out of the field of the small cooperative you introduce another element. I may be preaching heresy here; I may be in danger, but once you get into the field of the larger cooperative you have this different element; that you have your producers, who form the cooperative, and who may contribute the material resources to that cooperative which have to be disposed of; but personality of the producer and the personality of the consuming public who purchase those commodities, are two different



personalities. The consuming public may not be the same as the producers; they may be something additional, so you have not that factor in the case of a mutual insurance operation. In a mutual insurance operation the policyholder is the member. Nobody but a member is a policyholder, and nobody but the member, who is a policyholder, is entitled to anything by way of repayment of losses to the protection of the reserves of the company.

"11. Parliaments and legislatures have always recognized the fundamental difference between insurance and other business. Insurance and insurance organizations are frequently exempted from statutes relating to business generally and there are many statutes relating exclusively to insurance and insurance organizations.

"Mutual Insurance and Co-operatives

"12. Mutual insurance companies are the most natural organizations for the transaction of the insurance business. The earliest insurance organizations in the English-speaking world were mutual companies. Many of the mutual insurance companies transacting fire and casualty insurance in Canada and the United States of America are more than 100 years old.

"Mutual and Joint Stock Insurance Companies

"13. A mutual insurance company is a corporate entity chartered or organized under laws which specifically provide for this special type of corporation. It has no share capital or shareholders. The members of a mutual insurance company--" I should like to add there, so as to limit it to the particular companies with which I am concerned, "the members of an alliance mutual insurance company."

"--can only be persons who are insured. Their object in joining with other members is to secure protection.



The Company is operated by a board of directors elected by the members. Each member has one vote at all company meetings. The members own the mutual company, but no member can receive any profit from it. The mutual Company member is interested, first, in the insurance fund being sufficiently solvent to provide sound insurance protection and, secondly, in securing his insurance protection at the lowest cost."

I should like to preface the next sentence by adding these words, "Sound insurance at." The sentence will then read:

"Sound insurance at low cost is the only direct benefit which can come to a member of a mutual insurance company."

"14. A joint stock insurance company is a corporation financed by share capital contributed by shareholders. The shareholders are primarily interested in the corporation as proprietors of a business which, if successfully operated, will produce profit for them. A stockholder need not be a policyholder. The joint stock company deals with policyholders as third parties whereas a mutual company deals with policyholders as members. When a joint stock company does not share the benefits of favourable experience with its policyholders, it operates the insurance fund contributed by the policyholders and derives as much benefit for its shareholders as it can after paying all losses and expenses incurred. In the case of the mutual insurance company any such 'balance' is held for or returned to policyholders in the form of unabsorbed premiums.

"15. The public interest is served by the operations of both stock and mutual companies - because of the diversity in their practices and rate-making procedure. It is just as legitimate for the shareholders of a stock company





to engage in the insurance business for profit as it is for other persons to insure each other through a mutual company without purpose of profit.

"Mutual Insurance and Insurance on the Cash Plan"

"16. The member companies of the Alliance operating in Canada transact fire and casualty insurance on the mutual plan exclusively. Every policyholder is a member of the corporation and no policies are issued to non-members. In transacting 'mutual insurance' exclusively alliance member companies differ from practically all joint stock insurance companies in Canada which transact 'insurance on the cash plan' exclusively and from cash mutual insurance corporations which are empowered to transact insurance on both the mutual plan and on the cash plan. Many companies which are popularly known as mutual companies do not transact mutual insurance - or do not transact mutual insurance exclusively - as do all the Alliance member companies in Canada.

"17. 'The Insurance Act' of Ontario (R.S.O. 1937, c. 256) and similar acts in other provinces define 'mutual insurance' as a 'contract of insurance in which the consideration is not fixed or certain at the time the contract is made and is to be determined at the termination of the contract or at fixed periods during the term of the contract according to the experience of the insurer in respect of all similar contracts whether or not the maximum amount of such consideration is pre-determined' (sec. 1, par. 43)."

That means you may initially assess a premium, and your policy may be non-assessable and still it may be mutual insurance under the statutory provision as to what shall constitute mutual insurance. So the fact that a policy is non-assessable in its terms does not take away from that policy being mutual insurance.



"They define 'insurance on the cash plan' to be 'any insurance which is not mutual insurance' (sec. 1, par. 34).

"18. The said Ontario Act and similar acts in other provinces also distinguish between a mutual corporation and a cash mutual corporation. A mutual corporation is defined as a corporation . . . which is empowered to transact mutual insurance exclusively (sec. 1, par. 42): "a cash mutual corporation' is defined as 'a corporation . . . which is empowered to undertake insurance on both the cash plan and the mutual plan' (sec. 1, par. 11).

"19. Alliance member companies in Canada are all 'mutual corporations' and transact 'mutual insurance' exclusively within the meaning of the foregoing definitions. They do not transact 'insurance on the cash plan.'

"20. 'Mutual insurance' is illustrated by the figures in appendices III and IV post, which set out the underwriting accounts in Canada of Alliance member companies. They show that the consideration, i.e., the cost, of mutual insurance is not fixed or certain at the time the member-policyholder receives his policy but is determined only after the unabsorbed premium (dividend) has been returned or credited to him. On the other hand, in the case of 'insurance on the cash plan' the cost is predetermined and the policyholder is never entitled to the return of any part of the premium."

If we look at appendices 3 and 4, for instance looking at appendix 3, which is in two parts, you will see that this gives you a statement for the calendar year showing the underwriting accounts in Canada of the Alliance members. The first page is for 1942. You have a list of the thirteen companies whom I represent. In the first column you have the total premiums earned. In the second column you have the losses incurred. In the third column you have the



expenses incurred, and in the fourth column you have the underwriting gain or loss; that is observing the language of Mr. Finlayson.

As I will have to say some time later on, and I think I may as well say it now, I believe the expression "underwriting gain or loss" has a special meaning in the insurance field, and does not convey the ordinary meaning of a profit. You might just as well say that because somebody is a man, that all men are the same. To say that gain is synonymous with the word "profit" is not necessarily so at all. Two people in a corporate way may be doing the same thing as part of their operation. The result of that may be a profit in one case, and in another case it may not. You may take an industrial company which may have a portfolio of investments; but if a financial company has a portfolio of investments the income in that case is something entirely different. So you have to look at the particular circumstances of the operation. I am not concerned over the use of the words "underwriting gain or loss," as to whether that expression constitutes any admission that it means a profit. I think we have to look at the facts to see whether in the circumstances in which the operation is carried on, it is in fact a profit, within the meaning of the Income War Tax Act or, secondly, whether it should be. Quite apart from the question of whether it is or not, secondly there is the question whether it should be on principle, and I think this commission is concerned in part with the principle as to whether or not the Income War Tax Act should invade the field of mutual insurance operation for the purpose of assessing income tax and whether there is any place where they can assess it, even if they contemplate going into the field.

Returning to this appendix, in the next column are shown the unabsorbed premiums, which represents the amount returned





to the policyholders, and in the last column you have the balance. You will notice that in that particular year, in the cases of some of these companies, the dividends, so-called, paid to the policyholders were in excess of the underwriting gain or loss. In other cases they were less, and the explanation of that will appear very shortly.

May I now turn to the next page of the appendix, which contains a similar statement for the year 1943. There you will see how the various companies disbursed their so-called policyholders' dividend and the balance which they had on hand at the end of 1943; and you will observe again that in the case of some of these companies they disbursed in policyholders' dividends more than the unabsorbed portion of the premium. But if we look at the recapitulation, which is appendix 4, of this operation over a period of fifteen years, which I think is the only fair way of getting a proper view of the operations, because you cannot truly relate your experience to one year, since in that year you might have substantial losses while in the next year you might have not-- if you take them over a period of fifteen years I think all the wrinkles are ironed out and you will get a trend. You will observe this interesting feature in appendix 4; that over a period of fifteen years, from 1929 to 1943, the amount of the balance which the thirteen companies held out of the unabsorbed portion of the premiums was two per cent. In other words, over a period of fifteen years these companies, by following a trend of a percentage return in each year to the various types of risk on the basis of the premiums paid-- it might be 20 per cent, it might be 15 per cent -- that they have returned to the policyholders 98 per cent of the unabsorbed portion of the premium, so that only two per cent was held; and there is not any charge on Canadian operation against that two per cent for head office expense and such



items as that which would more than consume the two per cent.

"21. With few exceptions; such as the policies of the so-called 'stock-mutuals' of the province of Quebec and one or two foreign joint stock companies, joint stock companies transacting fire and casualty insurance in Canada have elected to issue no 'mutual insurance' policies in Canada; they issue 'insurance on the cash plan' exclusively.

"Policyholders' Dividends

"22. Since the return of unabsorbed premiums is frequently called a policyholder's dividend, and the word "dividend" is usually used to denote a distribution of profit, it will be helpful to discuss the true purpose of policyholders' dividends in a company transacting mutual insurance.

"23. The objective of an insurance company should be to provide insurance protection to policyholders at the lowest possible price consistent with prudent insurance practice in regard to reserves, etc., and, in the case of stock companies, the provision of a reasonable rate of profit to shareholders. There are two broad methods by which this end can be achieved: the company can fix its premium at the lowest point which it estimates will bring in just sufficient revenue to meet all losses and expenses (and, in the case of stock companies, to yield a profit); or it can charge a higher initial premium and subsequently pay back part of that premium when the company knows just what losses and expenses have been incurred. All Alliance member companies adopt the second method. It is economically sound for it permits them to provide insurance at the lowest possible cost without the risk that the amount received in premiums will be insufficient to cover the claims and expenses incurred."



"24. The part of the initial premium which is refunded to the policyholder by a mutual insurance company applying this second method is known as the unabsorbed premium or, more commonly, as the 'dividend to policyholders'. The name 'dividend' is a misleading one because, as has been mentioned, a 'dividend' is usually associated with the distribution of profits. The policyholders' dividend, however, is not a distribution of profit; it is merely the repayment of part of the initial premium - a repayment, furthermore, which is anticipated by the policyholder when he pays his initial premium. In other words, the initial premium which a policyholder in a mutual insurance company applying this method expects ultimately to pay is not the amount handed over to the company in the first instance but that original amount less his dividend.

"26. This view is supported by the fact that taxpayers who are permitted to deduct fire and casualty insurance premiums from their taxable income as operating expenses are only permitted to deduct 'net premiums,' i.e., the initial premiums less any policyholders' dividends that have been received. If a corporate taxpayer has a property which is continuously insured by a joint stock insurance company at a premium of \$1,000 per year, it may deduct \$1,000 each year as expense in calculating its income tax. If the same corporate taxpayer insured the same property continuously in an alliance member company, the annual deduction for insurance expenses might be \$700. The reduced expense deduction (\$700 instead of \$1,000) in calculation of the corporation's income tax would be due to the fact that each year unabsorbed premiums would be returned or credited to it. This appears to be a clear recognition on the part of the taxing authority that the policyholders' dividend is a return of part





of the initial premium and is not a distribution of profit.

"26. The Commission will be interested in the practical operation of the mutual insurance system as followed by Alliance member companies. Reference is made to the manner in which the amount of unabsorbed premiums (dividends) paid or credited to policyholders is determined by the boards of directors of the several companies. Accordingly there is included as Appendix V extracts from resolutions in this connection recently adopted by four representative Alliance member companies."

If I might take a typical one at the end, I will take the last one, the National Retailers Mutual Insurance Company, on the last page; there is a resolution of the directors, as follows:

"Voted, That on all policies expiring or cancelled during the month of May, 1944, and thereafter so long as the condition of the company shall warrant in the judgment of the executive committee or until further action by the board of directors or the executive committee, there shall be returned to the policyholders unabsorbed premiums (dividends) according to the following rates and classifications:"

Then they go on to define class A, on which the return is 20 per cent of the earned premium; class B, on which the return is 25 per cent of the earned premium, and class I on which the return is 15 per cent of the earned premium.

The resolutions of the other companies, which are appended, follow the same general plan; therefore I will not bother reading them all to the Commission.

#### "Insurance Company Taxation in Canada

"27. Notwithstanding that Alliance member companies are exempt from the Income War Tax Act and Excess Profits Tax Act by reason of clause (g) of section 4 of the former act, they feel that the taxes imposed on the premiums



received by them under the Special War Revenue Act are unfairly discriminatory inasmuch as such premiums are taxed at the rate of 3 per cent whereas premiums received by joint stock insurance companies are taxed only at the rate of 2 per cent.

"28. It is only fitting and proper that purely mutual companies which have no share capital and no shareholders and which therefore earn no 'income' or 'profit' within the generally accepted meaning of those terms in income tax law should be exempt from the Income War Tax and Excess Profits Tax Acts. Nevertheless this exemption is no justification for levying a higher rate of taxation upon premiums received by mutual insurance companies than by joint stock companies under the Special War Revenue Act.

"29. This discrimination first arose in 1942. From 1932 until 1942 all mutual and joint stock insurance companies operating in Canada were taxed on premiums received by the several provinces at the same rate (averaging about two per cent) and by the Dominion under the Special War Revenue Act at the rate of one per cent. During this period joint stock companies were permitted to deduct the Dominion premium taxes so paid from the taxes payable by them under the Income War Tax and Excess Profits Tax Acts. In 1942, when the provinces by arrangement with the Dominion agreed not to tax corporations for the duration of the war, the rate of the tax payable by the mutual companies under the Special War Revenue Act was increased from one per cent to three per cent but the rate of tax imposed on the joint stock companies was increased from one per cent to only two per cent.

"30. Alliance member companies do not object to the imposition of a premium tax provided premiums received





by them are not taxed at a higher rate than premiums received by other insurance organizations. The administration of a premium tax is simple and effective and it can be made equitable. The first condition of equity is that it be imposed at the same rate upon all competing types of insurance organizations. Prior to 1942 premiums received by mutual and joint stock insurance companies were taxed by every province at the same rate."

And I would direct particular attention to the next sentence:

"Every state in the United States of America taxes premiums received by insurance organizations, and in no state is a higher rate of tax imposed upon mutual than upon joint stock insurance companies.

"31. It seems altogether proper that joint stock insurance companies which frankly engage in the business for profit of their shareholders should be taxed under the Income War Tax and Excess Profits Tax Acts while mutual insurance companies are exempt from taxation under such acts. Since such a tax on a joint stock insurance company is levied only on the profit element of the premium, it only affects the amount of such profit, and therefore does not produce an element of discrimination as between joint stock and mutual insurance companies. The share capital and the shareholder are characteristics of the organization of a joint stock insurance company that are not found in the organization of a mutual insurance company. It is in accordance with Canadian income tax principles that the profits of such joint stock companies in the insurance business should be taxed, just as are the profits earned by joint stock companies in other lines of business.

"Insurance Company Taxation in Great Britain





"32. Inasmuch as other submissions made to the Commission have dealt rather fully with insurance company taxation in Great Britain, the Alliance contents itself with drawing attention to three important facts:

'1. In Great Britain there is no tax on premiums received by insurance companies, i.e., no premium tax such as is generally imposed throughout Canada and the United States of America;

'2. Mutual companies transacting fire and casualty insurance in Great Britain are very few in number and transact an inconsequential volume of business; and

'3. Mutual insurance organizations were not even mentioned in the debate in the House of Commons in 1933 when the British Income Tax law was amended to change the basis of taxation of cooperatives generally.'

"By reason of these three considerations, and having regard to the very different incidence of income tax law in Great Britain as compared with Canada or the United States of America, it is probable that the Commission will find little assistance by reference to the taxation of insurance companies in that country.

"Federal Taxation of Mutual Insurance  
Companies in the United States"

"33. From the time of World War I until the enactment of the Revenue Act of 1942, it may be said fairly that no federal income taxes were consciously levied by the Congress on mutual fire and casualty insurance companies.

"34. In the United States the federal income tax law, as it affects corporations and business enterprises, is essentially a tax on profits. It is the general rule that, where there are no profits, there are no income taxes to pay. The exemption of mutual insurance companies from



federal income taxation up until 1942 was based squarely on the proposition that such companies earn no profits.

"35. In 1942 it was proposed that the Congress levy income taxes on the larger mutual fire and casualty companies. It was proposed to tax them as profit-making corporations. The original bill contained a feature which would have penalized the mutual return of unabsorbed premiums to members.

"36. The congress, more specifically the committee on finance of the senate, considered fully the real status of mutual insurance companies. After conferences with congressional tax experts the congress concluded that mutual insurance companies are basically non-profit organizations. The need for revenue caused by the war led the congress, however, to examine the operations of mutual fire and casualty insurance companies very closely for the purpose of determining whether there was not some element in their operations which would support an income tax. It was concluded that the investment income which mutual fire and casualty companies earn on the funds in their possession should be taxed.

"37. The Revenue Act of 1942 exempts from taxation all mutual insurance companies, other than life or marine, if their gross income from premiums, assessments, interest, dividends and rents does not exceed \$75,000 during the taxable year. The provision is section 101(11) of the Internal Revenue Code. It has not been amended since 1942.

"38. The Revenue Act of 1942 placed section 207 in the Internal Revenue Code in its present form. It has not been substantially amended since 1942. This section provides for the taxation of mutual insurance companies, other than life, marine or fire companies issuing perpetual policies





exclusively. Mutual fire and casualty companies in which gross annual income from premiums, assessments, interest, dividends and rents is in excess of \$75,000 are taxed on whichever of two bases produces the higher tax:

"(1) Investment income tax. Net investment income is taxed at regular corporation income tax rates.

"(2) One per cent, gross income tax. Net premiums plus gross investment income, less tax-free interest, are taxed at one per cent. Net premiums are: Gross premiums less return premiums, premiums paid for reinsurance, and amounts returned to policyholders on the basis of experience, i.e., dividends to policyholders."

I direct the attention of the commission to the definition of what net premiums are according to the United States legislation, which I suggest should be persuasive here. There was some discussion during the hearing to-day that the United States had imposed an income tax in an alternative form upon the operations of mutual companies in the United States, and this is the form of the legislation. That is, it may be an income tax at the prevailing rates upon the net investment income, or it may be a one per cent gross income tax. Then they go on to define what shall be included in, shall we say, the taxable income; and they say that the net premium shall be included, but they deduct from the gross premiums any policyholders' dividends before they arrive at a figure which they tax on a gross income tax basis. So I say it is persuasive, even in the conception which the Federal government of the United States took, that they did not regard the return of the unabsorbed portion of the premium, to the extent that it was returned, as any part of the income



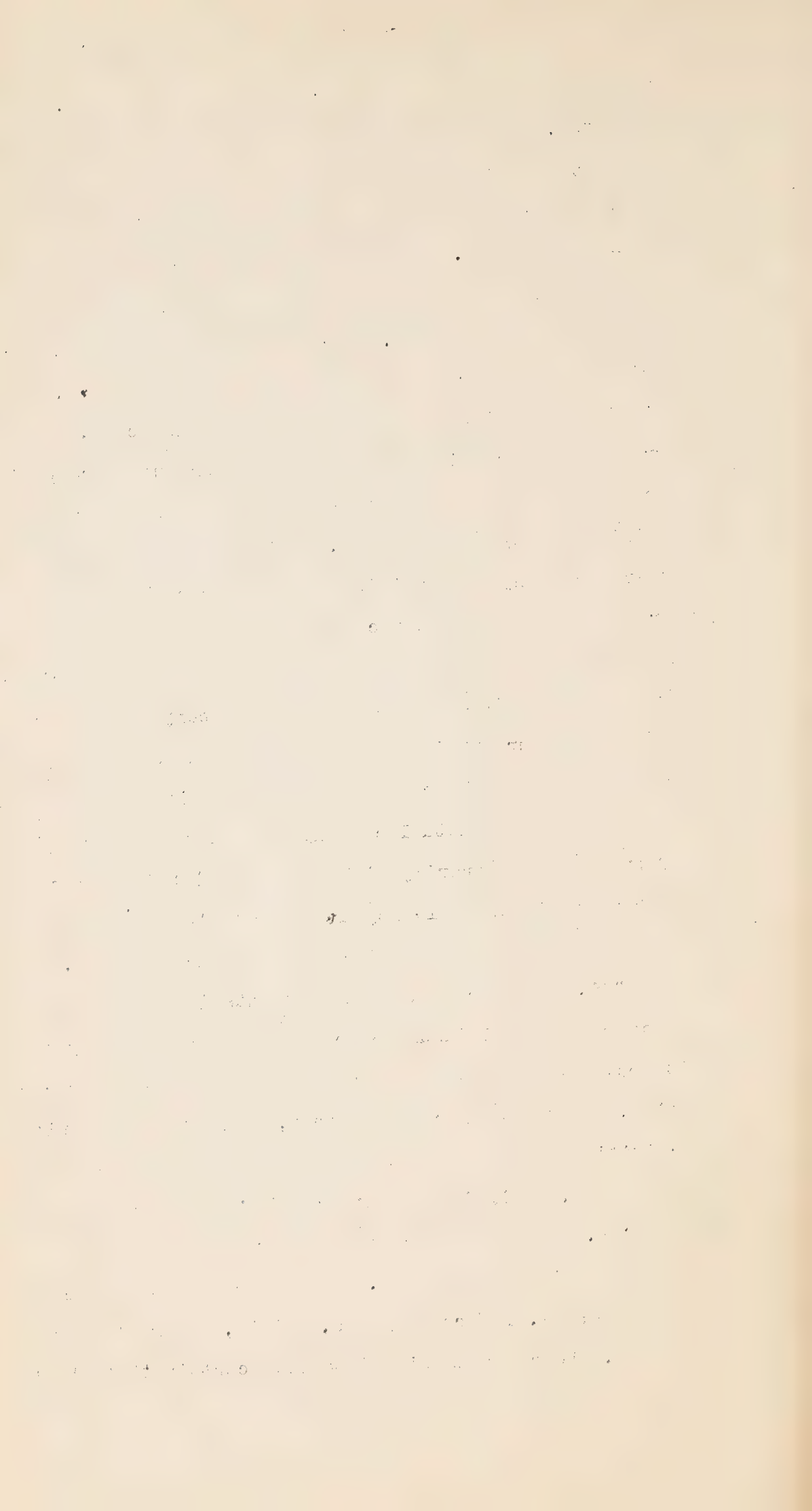


for purposes of this one per cent gross income tax.

"39. The investment income tax is levied on the theory that in so far as the underwriting activities of a mutual insurance company are concerned the operation is on a non-profit basis. The mutual insurance company is recognized as a membership organization for the insurance of the risks of its members at cost. A company may have good underwriting experience or bad underwriting experience, but the liability for income taxes will not be affected. The congress also recognized the necessity for mutual companies holding surplus funds for the purpose of maintaining their ability to pay their losses. During a good underwriting year a company may anticipate bad years and set aside from premiums an amount considered to be adequate to meet losses when heavy losses average out the good experience. The board of directors of a mutual company may retain amounts as surplus in any year on the basis of its judgment of the needs of the company for meeting its obligations. The surplus of a mutual company in so far as it consists of premiums temporarily withheld from distribution to members to insure solvency and ability to meet losses may be augmented without the incursion of income taxes.

"40. Net income from investments is taxable in the hands of a mutual insurance company in the same way that it would be taxable in the hands of a profit-making corporation. The congress reasoned that, while the underwriting activities of mutual insurance companies are non-profit operations, their investment activities produce some profits.

"41. The one per cent tax on gross income is an anomaly in income taxation. It is recognized as such by all concerned. The country was, and is, in great need of revenue. The congress wished to make certain that about



\$5,000,000 of additional revenue would be produced from the tax on mutual insurance companies, at least for the duration of the war. This tax must be paid if it exceeds the income tax which a company developed on its investment income."

I just want to call attention to this last sentence:

"The experience of many mutual insurance companies which pay income taxes in the United States under the Revenue Act of 1942 is that the tax computed on investment income is not much greater or much less than the tax computed on the one per cent of gross income basis.

"42. It follows from the foregoing that even if the Income War Tax and Excess Profits Tax Acts in Canada were to be amended by the addition of some new provision providing for the taxation of mutual fire and casualty insurance companies on a basis comparable to the provision taxing such companies in the United States Revenue Act of 1942, the new tax so imposed would approximate a premium tax of one per cent. One per cent is the exact difference in the rate of premium tax now paid in Canada by Alliance member companies in contrast to that paid by joint stock insurance companies under the Special War Revenue Act."

I think this might be just as good a place as any to direct the attention of the Commission to this additional feature, which affects the operations of the mutual insurance companies whom I represent in Canada. It is this. From the time this provision was re-enacted in the Special War Revenue Act 1932, placing this premium tax upon the premiums of a mutual company operating in Canada -- at that time the tax was a dominion tax of one per cent and a provincial tax of one per cent. Then when the federal authority took over the field of corporate taxation, in 1942, certain amendments were made stepping up the rate. In the case of the mutual





companies they added the one per cent federal tax which theretofore existed and the one per cent provincial tax which theretofore existed, and they got a sum total of three per cent. What was the basis on which they made it three per cent, I do not know.

THE CHAIRMAN: When you say "they" whom do you mean?

MR. HAYDEN: I would say that the Minister of Finance must assume the responsibility, because it was his resolution and his amending bill. Who was behind that, I do not know; and therefore I cannot make any allegation. But I want to point out this additional feature, that since 1932 down to and including 1943, we paid our tax upon the basis of our net premium. That would be our premium income in Canada less the policyholders' dividends. Then in 1944 the superintendent of insurance comes along and makes a demand retroactive to 1932 for payment of this premium tax on the basis of the gross premiums. While by special order in council the retroactivity has been taken away to the end of 1943, there is now a demand that all these mutual companies pay the additional amount for 1944 since they, on the advice of counsel, continued to pay on the basis of the net premium. So that we are faced with the liability, at the present time, that the premium tax as far as these mutual companies which I represent are concerned may be three per cent, calculated upon the gross premium income, without any deduction for the policyholders' dividends returned to the policyholders.

THE CHAIRMAN: Do you mean you have been assessed for that?

MR. HAYDEN: Yes, we have been assessed in 1944 in this respect, that a written demand has been made upon each of these companies for payment of this additional amount, the same as a written demand was made last year for payment





of exactly the same amount for the period going back to 1932.

THE CHAIRMAN: And did you appeal the order?

MR. HAYDEN: There is no provision for appeal. The provision is that if you do not pay your tax or any part of it the minister may sue you, so such an invitation has been extended.

"Underwriting Profit

"43. Underwriting profit, or 'underwriting gain or loss' as it is called in the annual returns prescribed under the Dominion Insurance statutes, has been the subject of special comment by the dominion superintendent of insurance in his annual reports in recent years. It is for these reasons that appendices III and IV attached to this submission give fairly complete figures concerning the underwriting accounts in Canada of Alliance member companies during the last fifteen years and, more particularly, during the past two years."

I think we have already referred to appendices III and IV, except back of the recapitulations you have a separate statement in relation to each company, showing the amount of premium received and the amount of the policyholders' dividend. Together with paragraph 43, which I have just read, I wanted to read paragraph 48, moving it out of place just a bit.

"48. The figures included in Appendices III and IV showing underwriting accounts of Alliance member companies in Canada demonstrate beyond all question that they have really returned to their Canadian policyholder members unabsorbed premiums and have not piled up huge special or surplus reserves as is contended by some of their competitors. They show, for example, that during the calendar year 1942 the unabsorbed premiums (dividends) returned to the Canadian policyholders of these companies exceeded the amount of the so-called 'underwriting profit.' They



show that while in the calendar year 1943 the 'underwriting profit' exceeded the unabsorbed premiums so returned in the aggregate, in fact five of the thirteen companies listed returned more in unabsorbed premiums than they gained in 'underwriting profit' even in that year; above all they show that during the past fifteen years the aggregate net balance from underwriting operations is \$776.,910 or two per cent of the \$37,953,906 in premiums written by Alliance member companies during the period. Inasmuch as the 'expenses incurred' figures employed in calculating this net balance do not include any share of home office expenses attributable to Canadian operations, e.g., statistical, accounting, underwriting, claims supervision, advertising, audit, and home office salaries and travelling expenses, this apparent aggregate net balance of two per cent was really not a gain because no one would suggest that such home office expenses covering the whole fifteen-year period totalled less than two per cent of net premiums written even after due allowance is made for investment income which is not included for the purpose of calculating the 'underwriting profit.'"

Now I go back to paragraph 44:

"44. The underwriting accounts set out in the reports of the dominion superintendent of insurance present an accurate picture of the insurance transacted by the joint stock insurance companies. However, such underwriting accounts present an incomplete and consequently inaccurate picture of the insurance transacted by Alliance member companies, because the accounts do not reflect the return of unabsorbed premiums which these companies make to their policyholders.

"45. The term 'underwriting profit' has a definite technical meaning in insurance accounting. It must not be confused with the ordinary meaning of profit. This is



particularly true when the undersriting profit of mutual insurance companies is mentioned. In a mutual company underwriting profit might better be styled 'unabsorbed premiums.'

"46. In the report of the superintendent of insurance for the dominion for the year 1942 there appears at page ixvii two tables setting out figures which give the impression that mutual insurance companies earn large profits in relation to the profits earned by joint stock insurance companies. The figures set out underwriting profit developed in accordance with insurance accounting practice.

"Figures for premiums, underwriting profit and income and excess profits taxes are taken from Table A, 1942:

"Foreign deposit premium mutuals<sup>x</sup>

Premiums	\$1,275,072
Underwriting profit	633,232
Ratio: Underwriting profit to premiums	49%
Income and excess profits taxes	None

Foreign Other Mutuals<sup>xx</sup>

Premiums	\$6,171,055
Underwriting Profit	873,828
Ratio: Underwriting Profit to Premiums	14%
Income and Excess Profits Taxes	None

Foreign Joint Stock

Premiums	\$31,343,976
Underwriting Profit	1,603,909
Ratio: Underwriting Profit to Premiums	5%
Income and Excess Profits Taxes	1,262,693
Underwriting Profit less taxes	341,216
Ratio: Underwriting Profit less taxes to premiums	1%





"47. The above figures show that the foreign joint stock companies earned underwriting profits (in the technical sense) which were comparatively much smaller than those earned by the mutual companies and that the joint stock companies paid very substantial income and excess profits taxes while the mutual companies paid none. These figures, however, ignore the very substantial refunds of unabsorbed premiums made to their policyholders by the companies transacting mutual insurance.

x i.e., Factory Mutual Fire Insurance Companies

x x e.g., Alliance member companies.

"Insurance and Post-War Canada

"49. While Alliance member companies have their head offices in the United States, their mutuality makes them Canadian companies in respect to their Canadian business. Accordingly they venture to make the following comments on the relations between the taxation of insurance companies and Canada's post-war problems.

"50. If the tax laws of Canada were to be changed to make the technical 'underwriting profit' of mutual companies liable to income tax and excess profits tax or otherwise to increase the taxes payable by mutual fire and casualty insurance companies, the cost of fire and casualty insurance would be increased. Fire and casualty insurance is a protection which is required by all classes of individuals and business concerns throughout the country. It is therefore a very widespread cost of business operation.

"51. If Canada is to achieve anything approaching full employment in the post-war period, it is of the utmost importance that her price structure, and consequently the operating costs of all industries, be kept as low as possible.



The reason is this. The increase in the labour force which has taken place since the war, together with the vast technological improvements in agricultural production, make it clear that we cannot hope to employ in our war manufacturing industries as they existed before the war and in agriculture and the other extractive industries all the people who will be demobilized from the armed services or laid off from wartime industry. It will therefore be essential to retain as large<sup>a</sup> portion of our wartime industrial expansion as possible. To do this, markets must be found both at home and abroad for a substantial volume of new products. Our ability to compete for foreign markets will obviously be enhanced to the extent that we can keep our costs and our price structure low. To increase the domestic demand for Canadian manufactured products, we must also rely largely on low costs and consequent low prices, because such a large part of Canada's domestic purchasing power is derived from exports and consequently cannot be materially raised by domestic fiscal policy.

"52. Consequently, if the cost of fire and casualty insurance is raised by increased taxation of the mutual companies, a policy will be followed which is injurious to the encouragement of industrial activity and the achievement of a high level of employment in Canada after the war.

#### "Conclusion

"53. In conclusion, we would reiterate respectfully the following submissions:

- "(1) That the rate of tax imposed upon companies transacting mutual insurance exclusively under the Special War Revenue Act should not exceed the rate imposed upon joint stock companies;
- (2) that companies transacting mutual insurance exclusively should continue to be exempt from taxation under the Income War Tax and Excess Profits Tax Acts;



"(3) that the administration of a tax on insurance premiums is simple and effective and can be made equitable; and that the basic tax on all insurance companies should always be a premium tax based on the net premiums, i.e., upon the actual cost of the insurance protection to the policyholder."

There are just one or two observations I should like to make before I call upon Mr. Gruhn. If we are concerned with the principle, as I think we are, which should guide us in a consideration of whether or not mutual insurance operation should be the subject of income tax, and whether or not it has any profit which could be described as income within the meaning of the Income War Tax Act, I think if we look, for instance, to how the life insurance companies are dealt with we will have a lead. In life insurance you have some fully mutual companies, who write nothing but mutual business. Then you have companies which write nothing but non-par business, strictly stock operation. Then you have stock companies which write both types of insurance, that is the participating type, which is the type of insurance that we write, and the non-par.

What is the income tax approach to these operations? They do not approach the problem on the basis that they are corporations and that corporations are separate legal entities. We all know that; it is an old story in law, but it takes more than that to produce income, because some of the greatest corporate set-ups have lacked just that one thing, the taxable income, and sooner or later they have ended in bankruptcy or have been absorbed. So the approach there is this. For instance, you take the stock company which writes mixed life insurance, some of which is participating and some of which is not. With respect to the participating insurance, to the extent that the profits or earnings of the company arising both from the excess of premium income and from investment -- and investment is a substantial part of the





income of life insurance companies -- to the extent that those earnings are transferred to the shareholders' account on that participating plan, they are not subject to income tax.

In order to get under that category you must transfer, I think it is, a minimum of 90 per cent. To the extent that you transfer within the limits permitted out of earnings, moneys to shareholders' account, that is taxable income, and is taxed under the Income War Tax Act.

Now I say there must be something in the principle that underlies that which goes deeper than just taking a look at the corporate set-up and saying, "Well, it is a corporation, and it should pay income tax," or taking a look and saying, "Well, are they carrying on the business of insurers, or not?" It goes deeper than that; and I think the principle is that to the extent that the cost of insurance to the policyholder is reduced by some return that is made to him, the federal government in the case of life insurance concluded that this should not be taxable either in the hands of the company. In the hands of the individual naturally it is not taxable. He does not recognize those shades of difference between the contribution which he originally made by way of premium and the character or the personality of the dividend that he gets back. It is money, or it is a credit in the way of a dividend; and he does not ask, nor do I think for the purposes of our consideration we would have to establish, that it was part of the money that we originally contributed, as long as he gets a return which applies to the cost of his insurance.

How does that apply to the mutual operation? We issue policies. My learned friends may be asking for those policies, so I may as well file a copy now. This is a standard automobile policy in the Lumbermens Mutual and



National Retailers, and there is a specific provision in the policy headed, "Mutual policy conditions," which says:

"The company is a perpetual mutual corporation, owned by and operated for the mutual protection and benefit of its members, in accordance with law and in accordance with the charter and by-laws of the company as now in force and as the same may be amended from time to time.

"The insurance shall under no circumstances be subject to assessment.

"This is a participating policy, under which the board of directors may, in its absolute discretion, subject to the charter, by-laws, classifications, and resolutions relating thereto determine and pay unabsorbed premium deposit refunds (dividend) to the insured."

That is the provision which is contained in the policy; and whether or not it was there I think the effect would be the same, when we hold ourselves out to be carrying on a mutual insurance operation, because the statute defines what a mutual insurance operation is. The essence of it is that there is no pre-determined amount for premium; and the proof as to how these companies have operated in fact is that over the period of fifteen years substantially all -- I think up to 98 per cent, which is all but 2 per cent -- of the premiums paid have been disbursed to the policyholders. That certainly indicates that in fact the company is carrying on a participating policy.

True, it is a corporation. The additional fact is that it has no shareholders; so it returns all these moneys to the policyholders. The advantage, of course, has been developed. The advantage of carrying on in that way, and getting the premium which permits of these surplus



funds to be returned in that way, is that you have money in hand against the possible losses, rather than having to deal with it in post mortem fashion. It is always more difficult, not only in matters of insurance but I suppose in almost any matter, to deal in a post mortem way with anything, except the person who says, "Well, I told you so." That is the person who is always right.

Then I wonder if Mr. Glassco could check this, because I spoke to him about it and he did not have any information on it. My understanding -- and I want to be corrected if I am wrong -- is that with respect to the operations of the British and foreign stock insurance companies in Canada, the income which they receive from investments is attributed to the head office, so that by some formula which is worked out they do not include the investment income as part of their taxable income. The best information I can get from various sources is that this was part of a formula. I asked my friend Mr. Glassco if he had any information on it, and I hope he will be able to check that in the meantime.

Another fact which I would like the commission to note at this time is that under the provisions of the internal revenue act in the United States, under section 204, United States joint stock companies issuing participating fire and casualty policies deduct the policyholders' dividends before arriving at the amount of earnings and income subject to tax. That is not something which is stated in my brief, but I wanted to bring it to the attention of this commission. In the United States, where they are dealing with participating policies and the question of the return of the unabsorbed premium, that is deducted before you arrive at an amount for the calculation of income tax and the determination of profit. Now, Mr. Chairman, my next step would be to





call Mr. Gruhn.

THE CHAIRMAN: Do you think we would make much headway by beginning with him now, if we adjourn at half past four? I think perhaps we might continue after we hear this other case to-morrow morning. Is that case said to be long?

MR. PARKER: No, my understanding is that it will not be long.

MR. BROSSARD: I do not expect so. You never can tell, but it may take an hour and a half or two hours at the most.

THE CHAIRMAN: Then I think it would be better if we adjourned now and resumed your case after hearing the other case first thing in the morning.

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At 4.30 p.m. the Commission adjourned until Wednesday, April 08, 1945, at 10 a.m.

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